



# NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

---

**MBA PROFESSIONAL REPORT**

---

## **RESPONSES TO FISCAL STRESS: A COMPARATIVE ANALYSIS**

---

**By: David Carroll,  
Peter Moon, and  
Dena Risley  
December 2013**

**Advisors: Douglas A. Brook, and  
Kathryn J. Aten**

*Approved for public release; distribution is unlimited*

THIS PAGE INTENTIONALLY LEFT BLANK

<b>REPORT DOCUMENTATION PAGE</b>			<i>Form Approved OMB No. 0704-0188</i>	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
<b>1. AGENCY USE ONLY (Leave blank)</b>		<b>2. REPORT DATE</b> December 2013	<b>3. REPORT TYPE AND DATES COVERED</b> MBA Professional Report	
<b>4. TITLE AND SUBTITLE</b> RESPONSES TO FISCAL STRESS: A COMPARATIVE ANALYSIS			<b>5. FUNDING NUMBERS</b>	
<b>6. AUTHOR(S)</b> David Carroll, Peter Moon and Dena Risley				
<b>7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)</b> Naval Postgraduate School Monterey, CA 93943-5000			<b>8. PERFORMING ORGANIZATION REPORT NUMBER</b>	
<b>9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES)</b> N/A			<b>10. SPONSORING/MONITORING AGENCY REPORT NUMBER</b>	
<b>11. SUPPLEMENTARY NOTES</b> The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government. IRB Protocol number ____N/A____.				
<b>12a. DISTRIBUTION / AVAILABILITY STATEMENT</b> Approved for public release; distribution is unlimited			<b>12b. DISTRIBUTION CODE</b> A	
<b>13. ABSTRACT (maximum 200 words)</b> The Budget Control Act of 2011 (BCA; Pub. L. No. 112-25, § 101, 125 Stat. 240) resulted from downward pressure on federal spending, as tax revenues decreased faster than expenditures and deficits became unsustainable. The BCA's discretionary spending caps mandate that the Department of Defense (DoD) cut \$500 billion in outlays between fiscal years 2013-2022. These spending caps, temporarily delayed by the American Taxpayer Relief Act of 2012 (ATRA; Pub. L. No. 112-240, § 901, 126 Stat. 2313), were realized on March 1, 2013, when \$37 billion was sequestered from DoD's current year budget. The discretionary spending caps and sequester resulted as a consequence of Congress's inability to stipulate \$1.2 trillion in cuts over a 10-year period in accordance with the BCA. Challenged by financial retrenchment, the DoD must now make choices within the framework of a new fiscal reality and fewer resources. How do DoD's financial retrenchment choices compare to historical choices of other government, quasi-government, and publicly traded organizations encountering similar fiscal stress? This project creates a framework through examination of comparable government, quasi-government, and publicly traded organizations to conduct a comparative analysis of the DoD's financial retrenchment choices.				
<b>14. SUBJECT TERMS</b> Fiscal Stress			<b>15. NUMBER OF PAGES</b> 119	
			<b>16. PRICE CODE</b>	
<b>17. SECURITY CLASSIFICATION OF REPORT</b> Unclassified	<b>18. SECURITY CLASSIFICATION OF THIS PAGE</b> Unclassified	<b>19. SECURITY CLASSIFICATION OF ABSTRACT</b> Unclassified	<b>20. LIMITATION OF ABSTRACT</b> UU	

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-89)  
Prescribed by ANSI Std. Z39-18

THIS PAGE INTENTIONALLY LEFT BLANK

**Approved for public release; distribution is unlimited**

**RESPONSES TO FISCAL STRESS: A COMPARATIVE ANALYSIS**

David Carroll, Lieutenant Commander, United States Navy  
Peter Moon, Captain, United States Marine Corps  
Dena Risley, Lieutenant Commander, United States Navy

Submitted in partial fulfillment of the requirements for the degree of

**MASTER OF BUSINESS ADMINISTRATION**

From the

**NAVAL POSTGRADUATE SCHOOL  
December 2013**

Authors: David Carroll

Peter Moon

Dena Risley

Approved by: Douglas A. Brook, Lead Advisor

Kathryn J. Aten, Support Advisor

William R. Gates, Dean  
Graduate School of Business and Public Policy

THIS PAGE INTENTIONALLY LEFT BLANK

# **RESPONSES TO FISCAL STRESS: A COMPARATIVE ANALYSIS**

## **ABSTRACT**

The Budget Control Act of 2011 (BCA; Pub. L. No. 112–25, § 101, 125 Stat. 240) resulted from downward pressure on federal spending, as tax revenues decreased faster than expenditures and deficits became unsustainable. The BCA’s discretionary spending caps mandate that the Department of Defense (DoD) cut \$500 billion in outlays between fiscal years 2013–2022. These spending caps, temporarily delayed by the American Taxpayer Relief Act of 2012 (ATPR; Pub. L. No. 112–240, § 901, 126 Stat. 2313), were realized on March 1, 2013, when \$37 billion was sequestered from DoD’s current year budget. The discretionary spending caps and sequester resulted as a consequence of Congress’s inability to stipulate \$1.2 trillion in cuts over a 10-year period in accordance with the BCA. Challenged by financial retrenchment, the DoD must now make choices within the framework of a new fiscal reality and fewer resources. How do DoD’s financial retrenchment choices compare to historical choices of other government, quasi-government, and publicly traded organizations encountering similar fiscal stress? This project creates a framework through examination of comparable government, quasi-government, and publicly traded organizations to conduct a comparative analysis of the DoD’s financial retrenchment choices.

THIS PAGE INTENTIONALLY LEFT BLANK



## TABLE OF CONTENTS

<b>I.</b>	<b>INTRODUCTION.....</b>	<b>1</b>
<b>A.</b>	<b>PROJECT BACKGROUND.....</b>	<b>1</b>
<b>B.</b>	<b>PROJECT OBJECTIVE.....</b>	<b>2</b>
<b>C.</b>	<b>RESEARCH QUESTION .....</b>	<b>3</b>
<b>D.</b>	<b>SCOPE .....</b>	<b>3</b>
<b>E.</b>	<b>METHODOLOGY .....</b>	<b>4</b>
<b>F.</b>	<b>STRUCTURE OF THE PROJECT .....</b>	<b>4</b>
<b>II.</b>	<b>LITERATURE REVIEW .....</b>	<b>7</b>
<b>A.</b>	<b>INTRODUCTION.....</b>	<b>7</b>
<b>B.</b>	<b>UNDERSTANDING FISCAL STRESS UPON AN ORGANIZATION ....</b>	<b>7</b>
1.	Relaxed Scarcity.....	8
2.	Chronic Scarcity.....	8
3.	Acute Scarcity.....	9
4.	Total Scarcity .....	9
<b>C.</b>	<b>CAUSES OF FINANCIAL RETRENCHMENT .....</b>	<b>11</b>
1.	Problem Depletion .....	12
a.	<i>Demographic Shifts.....</i>	<i>13</i>
b.	<i>Problem Redefinition .....</i>	<i>13</i>
c.	<i>Policy Termination.....</i>	<i>13</i>
2.	Environmental Entropy.....	13
3.	Political Vulnerability.....	14
4.	Organizational Atrophy .....	14
<b>D.</b>	<b>EFFECTS OF FINANCIAL RETRENCHMENT.....</b>	<b>14</b>
1.	Signaling Fiscal Norm Changes.....	15
2.	Establishing Budget Ceilings and Targets.....	16
3.	Power Shift between Claimants and Conservators.....	16
4.	Seeking Program Performance Over Potential.....	17
<b>E.</b>	<b>MANAGING FINANCIAL RETRENCHMENT: STRATEGIES AND TACTICS .....</b>	<b>18</b>
1.	Resist and Delay Strategies .....	20
2.	Minimize and Manage Strategies .....	21
<b>F.</b>	<b>FACTORS INFLUENCING RETRENCHMENT STRATEGY AND TACTICS.....</b>	<b>22</b>
1.	Financial Environment.....	23
a.	<i>Intensity and Duration.....</i>	<i>23</i>
b.	<i>Budget Flexibility.....</i>	<i>23</i>
2.	Political Environment.....	24
a.	<i>Policy Objectives .....</i>	<i>24</i>
b.	<i>Bureaucratic Inertia .....</i>	<i>24</i>
c.	<i>Externalities .....</i>	<i>25</i>
3.	Organizational Influences .....	25
a.	<i>Autonomy .....</i>	<i>25</i>

G.	FINANCIAL RETRENCHMENT CHALLENGES .....	25
1.	The Paradox of Irreducible Wholes .....	26
2.	The Management Science Paradox .....	26
3.	Free Exit Problem .....	27
4.	Tooth Fairy Syndrome .....	27
5.	Participation Paradox.....	27
6.	Productivity Paradox.....	28
7.	Efficiency Paradox .....	28
H.	CONCLUSION .....	28
III.	COMPARATIVE GOVERNMENT, QUASI-GOVERNMENT AND PUBLICLY TRADED ORGANIZATIONS.....	31
A.	COMPARATIVE ORGANIZATIONS—CHARACTERISTICS .....	31
1.	Type/Cause of Fiscal Stress.....	32
2.	Duration of Fiscal Stress .....	32
3.	Strategic Response .....	33
4.	Autonomy.....	33
B.	COMPARATIVE ORGANIZATIONS—DOCUMENT REVIEW .....	34
1.	Government Organizations.....	34
a.	<i>Why the United States?</i> .....	34
b.	<i>Why State Level Government?</i> .....	34
c.	<i>Why California (2010), Massachusetts (2009), and New Jersey (2010)?</i> .....	35
d.	<i>California (2010)</i> .....	37
e.	<i>Massachusetts (2009)</i> .....	38
f.	<i>New Jersey (2010)</i> .....	38
2.	Quasi-Government Organizations .....	39
a.	<i>United States Postal Service (USPS)</i> .....	40
b.	<i>National Railroad Passenger Corporation (Amtrak)</i> .....	41
3.	Publicly Traded Organizations.....	42
a.	<i>Why the United States?</i> .....	43
b.	<i>Why Fortune 500 Companies?</i> .....	43
c.	<i>Why Ford and IBM?</i> .....	43
d.	<i>Ford Motor Co</i> .....	43
e.	<i>International Business Machines (IBM)</i> .....	45
C.	COMPARATIVE ORGANIZATIONS—LIMITATIONS.....	45
D.	CONCLUSION .....	46
IV.	ANALYTICAL FRAMEWORK.....	47
A.	COMPARATIVE ORGANIZATIONS—DATA EXAMINATION .....	47
1.	Government Organizations.....	47
a.	<i>People</i> .....	47
b.	<i>Performance</i> .....	49
c.	<i>Budget</i> .....	51
2.	Quasi-Government Organizations .....	54
a.	<i>People</i> .....	54
b.	<i>Performance</i> .....	55

	c.	<i>Budget</i> .....	56
3.		Publicly Traded Organizations.....	58
	a.	<i>People</i> .....	58
	b.	<i>Performance</i> .....	58
	c.	<i>Budget</i> .....	60
B.		ANALYTICAL FRAMEWORK — DEVELOPMENT.....	61
1.		Establishing the Three-Sector Framework .....	61
C.		COMPARATIVE ORGANIZATIONS — ANALYSIS .....	63
1.		Minimization Strategy and Tactics .....	63
	a.	<i>People</i> .....	63
	b.	<i>Performance</i> .....	63
	c.	<i>Budget</i> .....	64
2.		Management Strategy and Tactics.....	65
	a.	<i>People</i> .....	65
	b.	<i>Performance</i> .....	66
	c.	<i>Budget</i> .....	67
D.		CONCLUSION .....	68
V.		DOD’S FINANCIAL RETRENCHMENT CHOICES — A COMPARATIVE ANALYSIS .....	69
A.		DEPARTMENT OF DEFENSE—DATA EXAMINATION .....	70
1.		Type and Cause of Fiscal Stress .....	70
2.		Rate and Duration of Fiscal Stress .....	71
3.		Retrenchment Choices that Support a Minimization Strategy .....	72
	a.	<i>People</i> .....	72
	b.	<i>Performance</i> .....	72
	c.	<i>Budget</i> .....	73
4.		Retrenchment Choices that Support a Management Strategy .....	74
	a.	<i>People</i> .....	74
	b.	<i>Performance</i> .....	75
	c.	<i>Budget</i> .....	76
B.		THREE-SECTOR ANALYTICAL FRAMEWORK .....	76
C.		DEPARTMENT OF DEFENSE—COMPARATIVE ANALYSIS .....	78
1.		Minimization Strategy and Tactics .....	78
	a.	<i>People</i> .....	78
	b.	<i>Performance</i> .....	78
	c.	<i>Budget</i> .....	79
2.		Management Strategy and Tactics.....	80
	a.	<i>People</i> .....	80
	b.	<i>Performance</i> .....	81
	c.	<i>Budget</i> .....	82
D.		CONCLUSION .....	83
VI.		CONCLUSIONS AND RECOMMENDATIONS.....	85
A.		RESEARCH QUESTION .....	85
B.		FINDINGS .....	85
C.		RECOMMENDATIONS FOR FUTURE STUDY .....	89

<b>D. CONCLUSIONS .....</b>	<b>90</b>
<b>LIST OF REFERENCES.....</b>	<b>93</b>
<b>INITIAL DISTRIBUTION LIST .....</b>	<b>99</b>

## LIST OF FIGURES

Figure 1.	Current and Constant Expenditure Values (from Rose, 1980) .....	11
Figure 2.	Causes of Public Organizational Decline (from Levine, 1980b) .....	12
Figure 3.	President's FY 2014 Budget Request (from OUSD[C], 2013a) .....	70

THIS PAGE INTENTIONALLY LEFT BLANK

## LIST OF TABLES

Table 1.	Tactics to Resist or Smooth Decline (from Levine, 1980b) .....	19
Table 2.	Percentage of Automotive Share 1995–2011 (from Shein & Bell, 2012) .....	44
Table 3.	Three-Sector Analytical Framework – Comparative Organizations .....	62
Table 4.	Three-Sector Analytical Framework – DoD .....	77

THIS PAGE INTENTIONALLY LEFT BLANK



## **LIST OF ACRONYMS AND ABBREVIATIONS**

ATRA	American Taxpayer Relief Act
BCA	Budget Control Act
CBO	Congressional Budget Office
CEO	Chief Executive Officer
CAFR	Comprehensive Annual Financial Reports
DoD	Department of Defense
FY	fiscal year
GAO	Government Accountability Office
GDP	gross domestic product
IBM	International Business Machines
NSS	National Security Strategy
OMB	Office of Management & Budget
PAEA	Postal Accountability and Enhancement Act
PRA	Postal Reorganization Act
PSRHB	Postal Service Retiree Health Benefits Fund
QDR	Quadrennial Defense Review
UAW	United Autoworkers Union
USPOD	United States Post Office Department
USPS	United States Postal Service

THIS PAGE INTENTIONALLY LEFT BLANK

## **ACKNOWLEDGMENTS**

We wish to express our appreciation to Professors Douglas Brook and Kathryn Aten of the Naval Postgraduate School of Business and Public Policy, for their expertise and guidance throughout the preparation of this MBA project; and to our spouses Melissa, Lindsey, and Rees, for their love and support.

THIS PAGE INTENTIONALLY LEFT BLANK

## **I. INTRODUCTION**

### **A. PROJECT BACKGROUND**

Over 2,981 people were killed during the terrorist attacks perpetrated on September 11, 2001 (9/11 Commission, 2004). Since then, American armed forces have been engaged globally, combatting terrorist organizations. The cost of this war against terrorism has been significant. The Department of Defense's (DoD's) total budget more than doubled from \$316 billion in 2001 to a high of \$691 billion in 2010 (Office of the Under Secretary of Defense (Comptroller) [OUSD(C)], 2013a). This sharp increase in discretionary spending, coupled with the nation-wide economic recession of 2008, placed downward pressures on the federal budget as expenditures exceedingly surpassed revenues and deficits became unsustainable.

The Budget Control Act of 2011 (BCA; Pub. L. No. 112–25, § 101, 125 Stat. 240) resulted from this downward pressure on federal spending. The BCA's discretionary spending caps mandate that DoD cut \$500 billion in outlays between fiscal years (FY) 2013–2022. These spending caps, temporarily delayed by the American Taxpayer Relief Act of 2012 (ATPR; Pub. L. No. 112–240, § 901, 126 Stat. 2313), were ultimately realized on March 1, 2013, when \$37 billion was sequestered from DoD's current year budget.

The DoD immediately retrenched by cancelling deployments and furloughing hundreds of thousands of civilian employees in order to meet short-term financial requirements imposed by sequestration. The BCA continues to authorize across-the-board sequesters to meet legislatively imposed discretionary caps until 2022. Thus, DoD is confronted with the prospect of long-term financial retrenchment.

On July 22, 2013, Secretary of Defense Charles (Chuck) Hagel signaled that financial retrenchment was the new fiscal norm and long-term retrenchment choices must be devised and implemented. Secretary Hagel announced that the Pentagon “must fundamentally reshape itself to adapt for a future of strategic and budgetary challenges” (DoD, 2013c, p. 1). He went on to note that while budget cuts have very damaging effects

on the military, DoD must prepare for the future and set clear, strategic priorities within the framework of a new fiscal reality and fewer resources (DoD, 2013c). Hagel noted, “These cuts are forcing us to make tough but necessary decisions to prioritize missions and capabilities around our core responsibility, which is the security of our country” (DoD, 2013c, p. 1). How, then, do these financial retrenchment choices compare to other organizations under similar fiscal stress?

## **B. PROJECT OBJECTIVE**

The objective of this project is to compare DoD’s financial retrenchment choices to historical choices of comparable government, quasi-government, and publicly traded organizations under similar fiscal stress. Based on these comparisons, we seek to discover similarities and differences, among the three sectors, that suggest if DoD’s financial choices during times of retrenchment are characteristic of an organization managing similar fiscal stress.

The financial choices of government, quasi-government and publicly traded organizations are all affected, to some degree, by their financial condition. The types and magnitude of these choices is partially explained by the amount of slack resources available to an organization. These slack resources, the difference between revenue and expenditures, relates to some level of fiscal stress within the organization. Unknown is if government, quasi-government and publicly traded sectors make different financial choices when managing similar fiscal stress and DoD’s choices compare.

Government, quasi-government and publicly traded organizations are selected for the purpose of examining multiple sectors to find if DoD’s financial retrenchment choices resemble those of a specific sector or are affected by the type of fiscal stress in general. The former suggests our findings reveal DoD’s financial retrenchment choices are liken to a specific sector. The latter finding would suggest financial retrenchment choices, common to all sectors, may be associated to the type of fiscal stress upon the organization.

### **C. RESEARCH QUESTION**

We seek to determine whether DoD's financial retrenchment choices, during times of financial retrenchment, are characteristic of other organizations managing similar fiscal stress. The similarities and differences among financial retrenchment choices of comparative organizations will ascertain whether DoD's choices reflect those of a particular sector, are unique to the DoD, or result from the type and cause of fiscal stress upon the organization. This project addressed various types and causes of fiscal stress along with the strategies and tactics used to manage them in order to identify comparative organizations, and their financial retrenchment choices.

### **D. SCOPE**

The scope of this project is limited to the financial retrenchment choices of government, quasi-government and publicly traded organizations, based in the United States, that exhibit multi-year acute fiscal stress caused by external factors.

This project examines three government organizations, two quasi-government organizations, two publicly traded organizations, and the DoD. The seven resulting comparisons to the DoD, include three different sectors and represent a variety of markets and industries. This is intended to identify intra and cross-sector commonalities and differences among financial retrenchment choices. The selection of seven comparative organizations and DoD was due to time and available resources.

This project's scope is strictly limited to a comparison of financial retrenchment choices for the purpose of analyzing DoD's retrenchment choices are characteristic of other organizations. It does not evaluate the effectiveness or efficiency at which any organization or financial retrenchment choice alleviates the effects of fiscal stress.

The scope of this project is also limited by the researcher's data collection and examination. The financial retrenchment decisions of any organization, throughout a prolonged period of fiscal stress, are numerous and diverse. There is a natural shortfall in our ability to identify an exhaustive record of every significant financial retrenchment choice. Specifically, our examination of state governments in specific years, preclude other financial retrenchment choices made in subsequent years.

## **E. METHODOLOGY**

This project is based on a literature review that builds a foundation for understanding fiscal stress. In the literature review, we examine theoretical as well as historic literature relevant to understanding fiscal stress, the causes of financial retrenchment, its effects, factors influencing organizational strategy and tactics, and the challenges ultimately stemming from financial retrenchment. This is applied to an analysis of government, quasi-government, and publicly traded organizations so that comparative organizations and their financial choices can be identified. Next, an examination of the financial retrenchment choices exhibited by DoD and comparative organizations is performed and their choices likened to retrenchment strategies and tactics drawn from the literature. These choices, categorized by the strategy and tactic they support, are presented within a three sector analytical framework. Finally, we present conclusions and offer recommendations.

## **F. STRUCTURE OF THE PROJECT**

Following this introduction, a literature review is presented in Chapter II. The literature review captures theoretical as well as historic literature relevant to understanding fiscal stress, the causes of financial retrenchment, its effects, factors influencing organizational strategy and tactics, and the challenges ultimately stemming from financial retrenchment. The contributions of various textbooks, academic literature, policy statements, articles, journals, and web-based archival databases are synthesized to provide a foundation of understanding as well as solidify the relevance and timeliness of this project.

Chapter III presents the information gained from an examination of comparative government, quasi-government, and publicly traded organizations. This chapter comprises a discussion of the characteristics sought in a comparative organization. Subsequently, the organizations are presented along with a discussion of their similarities and differences to the stated characteristics. The chapter closes with acknowledgements of our research limitations.



Chapter IV presents an examination of the financial retrenchment choices made by comparative organizations. The financial retrenchment choices are discussed and associated with a common retrenchment tactic. Next, a three-sector analytical framework is developed and discussed. The common retrenchment tactics of the comparative organizations are then added to the framework and the results presented.

Chapter V presents an examination of DoD's financial retrenchment choices. The type and cause of DoD's fiscal stress are discussed to liken them to the comparative characteristics. Then we review the DoD's financial retrenchment choices and associate these choices with their common retrenchment tactics. DoD's retrenchment tactics are added to the three-sector analytical framework and a comparative analysis is performed. The similarities, differences, and distinctiveness amongst choices are evaluated.

Chapter VI concludes with a presentation of conclusions and recommendations based on information collected and analyzed in Chapters I–V. We also provide recommendations for further research in Chapter VI.

THIS PAGE INTENTIONALLY LEFT BLANK

## **II. LITERATURE REVIEW**

### **A. INTRODUCTION**

This chapter presents background information from established literature that provides a foundation for understanding DoD's fiscal condition. First, we evaluate the topic of fiscal stress, distinguishing the different types and how they affect organizations. Second, we analyze the subject of financial retrenchment to include its causes and effects. Finally, we review strategies and tactics used to manage fiscal stress followed by their aftereffects.

### **B. UNDERSTANDING FISCAL STRESS UPON AN ORGANIZATION**

Understanding the type of fiscal stress upon an organization is fundamental to our endeavor. It is necessary to classify the fiscal stress associated with DoD's current financial position and to identify comparable government, quasi-government, and publicly traded organizations. By classifying the types of fiscal stress, we can identify the type of stress currently exhibited by DoD's, and find comparative organizations. Furthermore, DoD's financial retrenchment choices, and those of the comparative organizations, can be associated with a certain type of fiscal stress. This forms the informational base for comparative analysis.

Defining fiscal stress is a natural starting point. McCaffery and Jones (2001) briefly defined fiscal stress as a state in which difficulty is experienced in balancing revenues and expenditures over a long period of time. This is a rather simple definition. No government or organization has infinite resources and all have some form of internal politics or disagreement. Therefore, some level of difficulty in balancing limited revenues with organizational demands for expenditure always exists.

Allen Schick (1980) addressed the constant disparity between limited revenue and desired expenditure by looking at fiscal stress through the concept of scarcity. Schick (1980) highlighted that scarcity is a matter of both attitude and circumstance. Whereas a surplus may reflect availability of an ample budget margin or the restraint of a balanced budget mandate, a deficit may reflect a desperate shortage of funds to meet established

commitments or an organization's willingness to expand available resources for the purpose of creating economic growth. The attitude and circumstance of the organization allow it to perceive fiscal stress differently. Schick's (1980) definition, by his own admission, highlighted the difficulty in defining fiscal stress because it can be either real or perceived.

Schick (1980) noted that scarcity can be self-imposed but exists as a matter of circumstance for most governments, offered four categories of scarcity: relaxed scarcity, chronic scarcity, acute scarcity, and total scarcity.

### **1. Relaxed Scarcity**

Relaxed scarcity infers a government has sufficient resources to continue existing programs and to undertake substantial new budget commitments. Budgeting under relaxed scarcity reflects (1) a reorientation of budgeting from control (and/or management) functions to planning; (2) little review or evaluation of existing programs, which are permitted to continue and grow in incremental fashion; (3) a drawing together of planning and budgeting processes under the aegis of top policy officials; and (4) increased attention to program analysis and multiyear budgeting (Schick, 1980).

### **2. Chronic Scarcity**

Chronic scarcity reflects a government with enough funds to continue what is already being done, but not enough to cover all demands on public resources. Budgeting under chronic scarcity reflects the following: (1) The budget will not be used primarily to control spending, but emphasis will be placed on management improvements to reduce expenditures, increase funds available for new programs, and convey a sense of doing something about the budget situation. (2) Program analysis and evaluation are neglected. Evaluation (of established programs) has low priority because sufficient funds are available for continuation; analysis (of new programs) is unwelcome because funds are not available for substantial expansion. (3) Program development is sporadic and unsystematic. The preferred strategy is to approve a few programs that have low initial costs. (4) The multiyear implications of current policies are not emphasized, except when

political leaders want to dampen budget demands. (5) Planning is isolated from budgeting and policy making (Schick, 1980).

### **3. Acute Scarcity**

Acute scarcity states that available resources are insufficient to cover the incremental rise in program costs. Budgeting under acute scarcity reflects (1) use of the budget to limit spending by means of both aggregate and itemized controls; (2) retrenchment directed against the most vulnerable portions of the budget—discretionary programs, administrative and overhead costs, and maintenance activities; (3) not much budget-related planning, both because of the fixation on short-term gapsmanship and the sense that the government cannot determine its own fate; (4) a modest increase in evaluative activities; and (5) renewed emphasis on management efficiencies (Schick, 1980).

### **4. Total Scarcity**

Finally, total scarcity reflects when available resources are not adequate to cover ongoing government programs. Schick (1980) stated that total scarcity exists when a government is very poor or the demands for services are exceedingly high. It is futile for a government afflicted by total scarcity to try to balance supply and demand via the budget process. Resources cannot (or will not) be enlarged to meet demands, and the demands cannot be trimmed to suit the resources. Therefore, the budget situation is typically so precarious that it cannot be resolved by realistic means and escapist budgeting becomes rampant (Schick, 1980).

Fiscal stress, then, understandably involves pressure balancing revenue with demand for expenditures. Whether that pressure is real or perceived depends upon the organization's circumstance and attitude. The organization's actual financial condition, or circumstance, proves most useful in ascertaining real fiscal stress. Attitude is linked to perceived fiscal stress, and bears no application to identifying real fiscal stress within the organization's fiscal environment. Real fiscal stress is linked to four categories of scarcity that classify fiscal stress and probable behaviors: relaxed scarcity, implying sufficient resources to support growth; chronic scarcity, implying limited growth; acute scarcity,

implying an inability to support incremental growth; and total scarcity, implying an inability to provide baseline requirements. Which scarcity category reflects the DoD's current financial environment?

To measure the extent of real fiscal stress upon DoD and comparative organizations, so that it may be associated to a scarcity category, it is necessary to understand the various ways in which a budget cut can be interpreted. Large and complex budgets, such as DoD's, can be interpreted multiple ways. Whether DoD's budget is rising or falling is more a matter of definition, not fact (Rose, 1980). Defining a budget cut, then, begins with determining the baseline by which to establish a definition of the cut.

Once determined, the budget itself can be presented in terms of constant dollars, current dollars, percentage of gross domestic product (GDP), or percentage of resources contrasted to competing claimants and historical shares of mandatory and discretionary spending. These four presentations can portray different narratives about the same budget thereby allowing a presenter's motivation to influence the definition of a cut.

For our purposes, we focus on budget authority defined by constant and current dollars. This enables us to focus on the variation of actual budget authority in our effort to determine the extent of real fiscal stress upon the organization. Other means of defining the DoD's budget, such as percentage of GDP, contrasting against competing claimants or historical shares of mandatory and discretionary spending, remain valuable means of measuring budget trends within the federal government and often indicate political preferences. However, constant and current dollars are the manner in which we measure the DoD's actual budget authority because this highlights actual changes in budget authority, whereas comparative measurements contrast budget authority against something other than actual dollars received.

Richard Rose (1980) outlined four different ways public expenditure could change when measured in terms of both current and constant dollars. As depicted in Figure 1, they are (1) actual increases, (2) cuts without qualification, (3) spending squeeze, and (4) deflationary windfall. An actual increase occurs when constant and

current spending increase. Cuts without qualification occur when constant and current spending decrease. Spending squeezes occur when spending increases in current value but decreases in terms of constant value. This is a popular political option during periods of fiscal stringency because budgets are increased but less than the amount required to keep pace with inflation. Finally, deflationary windfalls occur when constant dollars decrease, but current dollars increase. Deflationary windfalls are mostly theoretical and would occur if deflation reduced prices but the DoD's budget authority in current terms decreased less than the overall fall in price levels (Rose, 1980).

		Constant Value	
		UP	DOWN
Current Value	UP	Actual Increase	Spending Squeeze
	DOWN	Deflationary Windfall	Cut w/out Qualification

Figure 1. Current and Constant Expenditure Values (from Rose, 1980)

An examination of historical and projected budget authority in terms of current and constant dollars enables us to classify DoD's fiscal condition into a scarcity category and select comparative organizations.

### C. CAUSES OF FINANCIAL RETRENCHMENT

Financial retrenchment is the act of reducing spending, beneath established baselines, in response to economic difficulty. This section describes the causes of financial retrenchment. Defining and categorizing the causes of financial retrenchment facilitates identifying the cause of DoD's fiscal stress. Understanding the cause of fiscal stress also contributes to identifying comparative organizations that exhibit similar fiscal stress.

Governments experience decline by erosion or plan, as they, and the services they provide, are constrained by the necessity of choosing how to use scarce resources (Peters & Rose, 1980). Societal or financial changes create “the necessity for governments to terminate some programs, lower the activity level of others, and confront tradeoffs between new demands and old programs rather than to expand whenever a new public problem arises” (Levine, 1980b, p. 14). Scarce resources are usually the underlying factor that necessitates an organizational change and also impacts how change is managed (Levine, 1980b). Levine (1980b) asserted that these changes occur primarily in response to internal or external conditions resulting from political, economic, and/or technical factors.

Levine (1980b) categorized four types, as depicted in Figure 2, they are: problem depletion, environmental entropy, political vulnerability, and organizational atrophy.

	Internal	External
Political	Political Vulnerability	Problem Depletion
Economic/ Technical	Organizational Atrophy	Environmental Entropy

Figure 2. Causes of Public Organizational Decline (from Levine, 1980b)

### 1. Problem Depletion

Levine (1980b) defined problem depletion as an external political factor that occurs when the government’s involvement in a short-term crises, such as a natural disaster or humanitarian assistance response, or medium-length engagements, such as war mobilization or long-term projects, have ended and are no longer required. Government involvement occurs in cycles that begin with “a political definition of a problem followed by the extensive commitment of resources to attain critical masses and then contractions after the problem has been solved, alleviated, or has evolved into a less troublesome stage or politically popular issue” (Levine, 1980b, p. 17).



Problem depletion usually results from factors such as demographic shifts, problem redefinition, and policy termination that are outside the government's control.

***a. Demographic Shifts***

A demographic shift occurs when there is a statistical change in the characteristics of a population. Levine (1980b) used school closings as an example of a demographic shift that occurs because of the aging population of an adjacent neighborhood. The aging population is an uncontrollable external factor and the decision to close a school is politically determined.

***b. Problem Redefinition***

Problem redefinition occurs when conditions, objectives, or scope of an original problem or policy are changed in some manner. To illustrate problem redefinition, Levine (1980b) demonstrated how bureaucracy downsizing and the rising patient costs of hospitalization, combined with pharmaceutical advances in antidepressants and tranquilizers, have caused public attitudes and professional doctrine to shift regarding the treatment and institutionalization of mentally ill patients.

***c. Policy Termination***

Policy termination is “the final phase of a public policy intervention cycle and can be defined as the deliberate conclusion or cessation of specific government functions, programs, policies, or organizations” (Levine, 1980b, p. 18).

**2. Environmental Entropy**

Environmental entropy is categorized as an external economic and/or technical factor. “Environmental entropy occurs when the capacity of the environment to support the public organization at prevailing levels of activity erodes” (Levine, 1980b, p. 18). This is often driven by taxpayers' preferences and their willingness to pay for particular activities.

### **3. Political Vulnerability**

Internal factors such as an organization's size, age, internal conflict, and leadership changes can affect its desire and ability to resist budget cuts. Typically, older organizations tend to be more established, flexible, and resistant to political vulnerability. According to Levine (1980b), "older organizations ought to have a broader range of adaptive skills, more capacity for learning, more friends and allies, and be more innovative because they have less to fear from making a wrong decision than a younger organization" (p. 19).

### **4. Organizational Atrophy**

Organizational atrophy is an internal economic and/or technical factor. Atrophy and declining performance are often attributable to a host of system and management failures such as "inconsistent and perverse incentives, differentiation without integrations, role confusion, decentralized authority with vague responsibility, too many inappropriate rules, weak oversight, stifled dissent and upward communication" (Levine, 1980b, p. 19). This is not a comprehensive list, and afflicted organizations may experience a combination of similar failures in parallel or at varying times.

Differentiating among the four decline situations facilitates in identifying the cause of DoD's fiscal stress. It is also an important characteristic that enables identification of comparative organizations which exhibit fiscal stress produced by similar causes.

## **D. EFFECTS OF FINANCIAL RETRENCHMENT**

It is a difficult undertaking for a government, either by choice or circumstance, to signal retrenchment internally across the organization as well as externally to its stakeholders. Public expenditure is naturally geared toward growth. In periods of relaxed scarcity, bottom-up budgeting with little executive guidance can characterize government budgeting. This way the government has time to evaluate the economic outlook, revenue projections, and the claims submitted by government agencies before determining where and what to cut from the budget (Schick, 1986).

The opposite is true during time of contraction or stabilization.

An unconstrained, bottom-up process can ignite a clash between agency spending expectations and the government's determination to restrain expenditure. If they are not blocked in advance, powerful spending claims can impel the government to spend (and tax or borrow) more than it prefers. Even if it rebuffs expansionary demands, by the time the government makes budget decisions, it might be too late in the budget cycle to achieve significant reductions in existing programs. (Schick, 1986, p. 83)

Therefore, in times of financial retrenchment a critical effect is the government's need to signal a change to the fiscal norm. A government must effectively signal that the current fiscal environment is unsustainable to set an expectation among agencies and its populace that expenditure spending will decrease. Choosing when and how to issue a new signal is the first topic we cover in this section. The second topic we address is how the government can utilize retrenchment tools, such as ceilings and targets, to achieve the objectives required by the fiscal environment. The final topic we examine is the manner and importance of altering the balance of power between fiscal conservators and claimants during times of retrenchment.

Collectively, these effects support an examination of DoD's fiscal condition and assist in ascertaining a scarcity category. These effects are evident within the federal government today and reinforce that the federal government and DoD are confronting prolonged fiscal stress.

## **1. Signaling Fiscal Norm Changes**

To contract government expenditure and to counter expansionary pressures, governments must signal fiscal norm changes before the start of budget preparations. These norms serve more as budget influencers than as strict budget objectives and are generally limited to key fiscal aggregates such as total revenues and expenditures and the balance between the two (Schick, 1986). Allen Schick (1986) provided an appropriate definition for the use and purpose of resetting fiscal norms during time of retrenchment to norms of decreased expenditure spending:

The norms tend to be political statements concerning the future orientation of government policy, and they are especially important when the government is altering the direction in which it is headed. The statement gives notice to spending agencies, interest groups, and the public at large that the budget is being reoriented from expansion to contraction. The purpose of the macro norms is to exert downward pressure on spending demands, so that both future spending and deficits will be significantly below the levels that would ensue if past trends were permitted to continue. (p. 83)

## **2. Establishing Budget Ceilings and Targets**

Announcing a need or desire to change the fiscal norm from growth to retrenchment is ineffectual unless the government can also provide guidance in the form of budget ceilings and targets to curb spending. This guidance must be vague in that it does not tie the government to a declared objective, but clear enough that agencies reduce future spending. These signals tend to be less productive in the short term and more productive in the long term as it is not uncommon for governments to discover, when they finally consider budget requests, that past commitments exceed the spending total contemplated by the norm (Schick, 1986, p. 83). Thus, the new fiscal norm signal may not yield remarkable short-term cuts despite the use of ceilings and targets.

However, the use of ceilings and targets is necessary to slow expenditure growth and reinforce the fiscal signal that spending will be reduced. “The ceilings and targets put claimants on notice that big increases are a thing of the past and that retrenchment is legitimate and necessary” (Schick, 1986, p. 83).

Many governments have incorporated expenditure ceilings and targets in their budget process because fiscal stress has become cyclical within industrialized countries. In the United States, a target within the first budget resolution is converted into a ceiling and manners by which these can be enforced are provided (Schick, 1986).

## **3. Power Shift between Claimants and Conservators**

A power shift between claimants and conservators must occur to successfully inhibit agency spending demands. Sending a strong signal that the fiscal norm must change is an effective tactic governments use to achieve this end. This tactic involves

restating budget issues in financial terms rather than program requirements. Conservators are strengthened when the government and populace begin to view changing a negative financial environment as more significant than specific program needs (Schick, 1986).

Once the political discussion is changed from one of program needs to one of altering a negative financial environment, ceilings can effectively be used to limit the amount for which an agency can ask. Use of a ceiling becomes an effective tool because it does not dictate what programs or cuts are to be made, only the amount to be requested (Schick, 1986). As a result, “budgetary debate revolves around spending and deficit levels, not around the activities to be retrenched by government” (Schick, 1986, p. 83).

When the political focus is on fixing the fiscal condition of the budget, targets also strengthen a conservator’s power. Targets “establish a presumption against expenditure in excess of the fixed level. If claimants seek more than the targeted amounts, claimants are open to the charge that they are behaving in a fiscally irresponsible manner” (Schick, 1986, p. 83). The targets also indicate the new level a program will be funded at, and the level to which expenditure growth will be adjusted, while leaving the claimants the onus of cutting their own programs (Schick, 1986).

#### **4. Seeking Program Performance Over Potential**

It is common, during times of financial retrenchment, for governments to invest in programs based on performance versus potential. “Performance—not potential—is the more relevant measure when the government seeks to curtail deficits or expenditures as a share in Gross National Product” (Schick, 1986, p. 83). Governments prefer to allocate scarce resources in performance proven programs because a lack of overall resources increases opportunity costs. The failure of an unproven program is therefore substantially magnified.

## **E. MANAGING FINANCIAL RETRENCHMENT: STRATEGIES AND TACTICS**

Throughout history industrialized governments have managed through difficult financial environments including periods of retrenchment. What, then, have been the traditional strategies and tactics used to confront the financial requirements of retrenchment?

Levine (1980b) distinguished an organization's retrenchment strategies as resist or smooth. A resist strategy infers tactics that aim to externalize the effects of fiscal stress from the organization. Conversely, a smoothing strategy infers an organization internalizes, at least some part of, the fiscal stress and implements tactics designed to deal with the effects. Table 1 summarizes the tactics associated with resist and smooth strategies and categorizes them by the cause of fiscal stress.

### Cutback Management Tactics

	Tactics to Resist Decline	Tactics to Smooth Decline
<i>External Political</i>	(Problem Depletion)	
	1. Diversify programs, clients and constituents 2. Improve legislative liaison 3. Educate the public about the agency's mission 4. Mobilize dependent clients 5. Become "captured" by a powerful interest group or legislator 6. Threaten to cut vital or popular programs 7. Cut a visible and widespread service a little to demonstrate client dependence	1. Make peace with competing agencies 2. Cut low prestige programs 3. Cut programs to politically weak clients 4. Sell and lend expertise to other agencies 5. Share problems with other agencies
<i>Economic/ Technical</i>	(Environmental Entropy)	
	1. Find a wider and richer revenue base (e.g., metropolitan reorganization) 2. Develop incentives to prevent disinvestment 3. Seek foundation support 4. Lure new public and private sector investment 5. Adopt user charges for services where possible	1. Improve targeting on problems 2. Plan with preservative objectives 3. Cut losses by distinguishing between capital investments and sunk costs 4. Yield concessions to taxpayers and employers to retain them
<i>Internal Political</i>	(Political Vulnerability)	
	1. Issue symbolic responses like forming study commissions and task forces 2. "Circle the wagons," i.e., develop a siege mentality to retain esprit de corps 3. Strengthen expertise	1. Change leadership at each stage in the decline process 2. Reorganize at each stage 3. Cut programs run by weak subunits 4. Shift programs to another agency 5. Get temporary exemptions from personnel and budgetary regulations which limit discretion
<i>Economic/ Technical</i>	(Organizational Atrophy)	
	1. Increase hierarchical control 2. Improve productivity 3. Experiment with less costly service delivery systems 4. Automate 5. Stockpile and ration resources	1. Renegotiate long term contracts to regain flexibility 2. Install rational choice techniques like zero based budgeting and evaluation research 3. Mortgage the future by deferring maintenance and downscaling personnel quality 4. Ask employees to make voluntary sacrifices like taking early retirements and deferring raises 5. Improve forecasting capacity to other users 6. Reassign surplus facilities to other users 7. Sell surplus property, lease back when needed 8. Exploit the exploitable

Table 1. Tactics to Resist or Smooth Decline (from Levine, 1980b)

Levine's work on cutback management, his classification of strategies, and his identification of tactics offers a suitable starting point. However, organizational responses to fiscal stress often prove more dynamic than the binomial choices offered by Levine. Organizations strategically choosing to resist may recognize the inevitability of internalizing some amount of the resulting effects at a later time. Thus, the tactics an organization chooses over a time period may comprise a range of alternative strategies designed to provide a methodical response. This methodical response may include tactics that internalize some effects of fiscal stress, but stop short of completely internalizing all of the effects.

Brook identified four strategies for managing the effects of fiscal stress. Organizations may offer strategic responses that resist, delay, minimize, or manage budget cuts and their resulting effects (Brook, 2013).

### **1. Resist and Delay Strategies**

Resist and delay strategies attempt to externalize, for varying lengths of time, the effects of fiscal stress. Whereas resisting endeavors to avoid retrenchment, delaying seeks to buy more time to prepare the organization for forthcoming cuts.

When resisting financial retrenchment, agencies often select tactics designed to highlight the importance of their mission in order to protect their people, performance, and budget from cuts. These tactics involve contrasting historical budget funding to other agencies or GDP, highlighting multi-year commitments requiring full funding, identifying a critical externality that demands funding, or lobbying the population at large to place pressure on political decision-makers. In the U.S. government, these tactics are common, not only during times of financial retrenchment, but even during times of financial growth as agencies lobby Congress for their "fair share" of appropriations.

Delaying the effects of financial retrenchment is a commonly used strategy when an agency believes fiscal austerity will be short-term, other resources are or will become available, or time will help build budget flexibility. Tactics involve budget manipulation or alternative sources of funding. Budget manipulation may involve optimistic economic scenarios, property sales or privatization of minor assets or services, inter-budget



borrowing, the timing of expenditures to occur in different reporting periods, the deferral of financial decisions, the shift of responsibilities to other organizations, or the finding of efficiencies or savings to make up the differences (Brook, 2013). Alternatively, governments with the ability to raise revenue may borrow, tax, or seek intergovernmental assistance from state or federal governments in order to balance budget shortfalls.

## **2. Minimize and Manage Strategies**

Minimize and manage strategies suggest internalizing, to varying degrees, the effects of fiscal stress. A minimize strategy typically produces retrenchment tactics that have a lesser impact to an organization's infrastructure and its long-term operational effectiveness, and produce immediate short-term savings. Management strategies have the greatest impact on an organization's people, performance, and budget. Tactics typically produce the greatest expenditure reductions, are slower in producing reductions, and have longer-lasting effects upon organizational effectiveness.

When financial retrenchment is unavoidable, whether it is expected to be short term or long term, agencies often choose first to minimize its effects. Tactics associated with minimizing strategies characteristically have a lesser impact on organizational infrastructure, and are quicker at providing immediate savings with lower impact to an organization's long-term operational effectiveness. If the effects of financial retrenchment are expected to be long-term, minimization tactics are commonly employed first, thereby enabling administrators time to consider long-term strategy and tactics. Minimization techniques also satisfy short-term budget cut requirements and can provide budget flexibility within an environment of financial retrenchment. Minimize tactics include hiring freezes, furloughs, crisis-to-crisis management, cutting or consolidating non-essential programs, small scale productivity and efficiency improvements, burden sharing with other agencies, deferring maintenance and capital investments, centralizing decision-making, allocating resources based on performance metrics, and renegotiating high-cost or long-term contracts (Wolman & Davis, 1980, pp. 232–233).

Finally, when financial retrenchment is long-term or exceptionally profound, an agency must choose to manage its effects and decide what tactics maintain the highest

levels of effectiveness within the limits of decreased funding. These tactics characteristically have the greatest impact on people, performance, and budget. While the tactics produce the greatest expenditure reductions, these tactics are slower in producing them, and have longer lasting effects on organizational effectiveness. Tactics include organizational restructuring, long-term transformation, low-cost labor alternatives or privatization, large-scale productivity and efficiency improvements, selling or leasing back surplus property, reducing personnel or capital equipment, early retirement options, and reducing or restructuring employee benefits.

Levine's classification of resist and smooth strategies offered a theoretical starting point to our analysis. Brook, finding more dynamic organizational responses to financial retrenchment, proposed resist, delay, minimize, and manage strategies.

These strategies, and the tactics used to support them, form the basis of our three-sector analytical framework. Financial choices, identified in Chapter IV's data examination, are presented within a three-sector framework associated with the strategy and tactic to which it corresponds.

The financial retrenchment confronting the DoD, as outlined in the BCA of 2011, demands it internalize and administer the forthcoming budget cuts. Therefore, this project, and the three-sector matrix, focuses on financial choices designed to strategically minimize and manage the effects of financial retrenchment.

## **F. FACTORS INFLUENCING RETRENCHMENT STRATEGY AND TACTICS**

This section will discuss factors influencing retrenchment strategy and tactics. Strategic choices are influenced by the financial environment, political environment, and organizational influences (Brook, 2013). Influences upon the DoD and comparative organizations are different, at least to some degree, because these organizations operate in distinct sectors. Thus, their retrenchment choices may differ as a result of these influential factors. Understanding these factors, and their sources, is important to support the development of conclusions and recommendations in Chapter VI.

## **1. Financial Environment**

### ***a. Intensity and Duration***

The variables of intensity and duration influence an organization's financial retrenchment choices by shaping its selection of strategy and tactics. As the intensity of financial scarcity varies, so too can its duration. Both affect how fast an organization reacts, how much it modifies, and for how long the organization must endure the retrenchment (Schick, 1980).

The intensity and duration shape multiple responses. A period of retrenchment that is believed to be short-term may elicit strategies that employ tactics with short-lived effects upon the organization. Conversely, if the period of retrenchment is believed to be long-term, an organization may choose more comprehensive strategies with longer-term effects. Organizations may also use multiple strategies simultaneously or sequentially as the intensity and duration of retrenchment increases.

### ***b. Budget Flexibility***

Another factor influencing retrenchment strategy and tactics is the considerable need to create budget flexibility during times of retrenchment. Budget flexibility is difficult to achieve because times of financial retrenchment often occur at periods when agencies need to be most flexible and adaptive. Irene Rubin (1980) asserted,

If changes are to be made, there must be flexibility in the budget to shift funds from one unit or program or budget line to another; if good personnel are to be retained, there must be sufficient flexibility to provide them incentives to stay on; if innovation is to occur, there must be some risk capital. If budget cutters are to maintain their effectiveness, they must have some resources with which to build and maintain coalitions. Otherwise, at the time leaders need the most support to make the most difficult decisions, they will have no support. The level of flexibility in the budget is thus an important factor in the ability of administrators to manage change; yet the level of flexibility in the budget at the time of retrenchment is highly problematic. (p.159)

Thus, budget flexibility is critical if an agency is to remain effective during periods of financial retrenchment. Organizations should consider the amount of

budget flexibility necessary to remain effective and choose strategies and tactics accordingly.

## **2. Political Environment**

### ***a. Policy Objectives***

An organization's policy objective and financial reputation influence its retrenchment strategy and tactics. Each agency has its policy objectives. For established objectives that continue to serve a purpose and enjoy public support, an organization may reasonably anticipate favorable funding from Congress (Wildavsky & Caiden, 2004). Favorable funding does not imply an organization will not be retrenched. It merely infers continued support for the organization's policy objective or, perhaps, fewer cuts when contrasted to competing claimants. An organization's retrenchment strategy and choice of tactics are thus influenced by the amount of public and congressional support for its policy objective.

An organization's financial reputation matters. Wildavsky and Caiden (2004) asserted, "The agency with a reputation for economy may be praised for turning funds back and not get them cut the following year, whereas the agency deemed to be prodigal may get slashed on the grounds it must not have needed the money in the first place" (p. 52). An agency's retrenchment strategy and tactics may be influenced by the agency's perceived ability to obtain reliable funding from Congress.

### ***b. Bureaucratic Inertia***

Bureaucratic inertia affects government, quasi-government and publicly traded organizations. Politicians are not likely to repeal benefits that millions of citizens are dependent upon, without significant penalties in the following election cycle. According to Peters and Rose (1980), "When all choices open to government are unpleasant, the most immediately comforting thing for a politician to do is seek a placebo" (p. 40). An organization may also suffer from a slow or ineffective response if leadership is intentionally indecisive or slow to respond because of deep-rooted policy objectives.

*c. Externalities*

Budgeting is a multiyear process. Agencies create budgets that strive and sometimes succeed at attaining a goal, but there is always an element of uncertainty regarding the future. As a result, “from time to time agencies are affected by emergent problems, current events that no one could have predicted but that will radically alter budgetary prospects for particular programs” (Wildavsky & Caiden, 2004, p. 52). The p

resident, Congress, and agencies are often obligated by these unforeseen events to modify budgets in originally unwanted ways. This political influence cannot be planned or budgeted for. Nevertheless, when an externality arises, an organization may alter its retrenchment strategy and tactics as it stands to increase, or further decrease, its resources as a result of the externality.

**3. Organizational Influences**

*a. Autonomy*

Autonomy is an important factor governing how an organization can respond to fiscal stress. Autonomy refers to the degree of control an organization has to raise revenue or decrease expenditures in response to fiscal stress. During times of financial retrenchment, organizations that have an ability to do so, traditionally choose some combination of increasing revenue and decreasing expenditure spending. The amount of autonomy an organization has to do so will significantly influence its selection and implementation of strategies and tactics.

**G. FINANCIAL RETRENCHMENT CHALLENGES**

Organizations experience consequences as a result of their financial retrenchment choices. According to Levine (1980a), public budgeting, personnel, and program management, dominated by resource scarcity, will require difficult management decisions regarding “cutbacks, tradeoffs, reallocations, organizational contractions, program terminations, sacrifice, and the unfreezing and freeing up of grants and privileges that have come to be regarded as unnegotiable rights, entitlements, and contracts” (p. 305).

“Cutback management means managing organizational change toward lower levels of resource consumption and organizational activity” (Levine, 1980a, p. 306). Levine (1980a) identified four major challenges managers encounter during cutbacks: (1) Organizational acceptance of change, under austerity, will be met with resistance when the potential for reward or personal gain is not present; (2) professional norms, civil service procedures, veteran’s preference, affirmative action commitments, and collective bargaining agreements constrain target cuts; (3) morale, job satisfaction, and productivity often suffer as a result of organization contractions; and (4) creativity, innovation, and risk taking significantly decline under constrained resources and cutback conditions.

Other specific challenges include the following:

### **1. The Paradox of Irreducible Wholes**

“An organization cannot be reduced piece-by-piece by simply reversing the sequence of activities and resources by which it was built” (Levine, 1980a, p. 306). An organization’s expertise, political support, facilities, equipment, and resources are accumulated over time and are often intertwined. Management must carefully consider the second- and third-order effects of its financial retrenchment choices.

### **2. The Management Science Paradox**

Levine (1980a) stated that organizations tend to invest in and build up their data systems and analytic capacity when resources are abundant. On the other hand, maintaining data systems and analytic capacity during times of austerity becomes difficult because an organization’s most talented analytic employees tend to leave for better opportunities elsewhere. In turn, hiring replacements becomes difficult or impossible because of hiring freezes. The organization and people remaining are left to suffer. In summary, when resources are slack or abundant, analytic capacity exceeds requirements, but when resources are scarce, analytic capacity can’t be maintained when needed the most.

### **3. Free Exit Problem**

Levine (1980a) explained that free riders are “people who take advantage of an organization’s collective goods without contributing their share to achieving the organization’s goals” (p. 307). He further explained how management should handle free riders during times of growth and decline. During times of growth, an organization’s goal is to prevent or exclude free riders from taking advantage of the organization when resources are slack. However, during times of decline or contraction, an organization “must find ways to limit (include) ‘free exiters,’ i.e., people who seek to avoid sharing the ‘collective bads’ produced by the necessity to make sacrifices by either leaving the organization or avoiding its sacrifices” (Levine, 1980a, p. 307). Declining or contracting organizations dealing with austerity must “design mechanisms to limit free exiters and reward valuable people for remaining in the organization through its difficult times” (Levine, 1980a, p. 307).

### **4. Tooth Fairy Syndrome**

Levine stated, “The initial prevailing attitude in the organization will usually be optimistic, i.e., that the decline is temporary and the cuts will be restored soon by someone—in some cases as remote as the tooth fairy” (Levine, 1980a, p. 307). During times of decline or contraction, employees usually experience resistance and cynicism in response to requests for voluntary budget cuts. There is a natural tendency to delay cuts, while middle and lower management often exhibit a “you first, then me” (Levine, 1980a, p. 308) attitude.

### **5. Participation Paradox**

The participation paradox encourages management to seek buy-in from employees, especially those who will likely bear the greatest cuts. According to Levine (1980a), “A rational cutback process will require that some people and programs be asked to take greater cuts than others” (p. 308). Management often finds it difficult to single out people or programs; therefore, it tends to avoid deadlocks and conflict by implementing across-the-board cuts.

## **6. Productivity Paradox**

The productivity paradox, according to Levine (1980a) and simply stated means “It takes money to save money” (p. 308). Productivity improvements often require up-front investment in training or equipment that becomes difficult to sustain when funds are scarce.

## **7. Efficiency Paradox**

An efficient organization will find it more difficult to find cost savings during times of scarce resources, because it will likely have already “exhausted most of the easy and obvious productivity improvement strategies” (Levine, 1980a, p. 309). When cuts across the board are implemented, “efficient organizations are likely to be penalized more than their poorly performing peers because they will be forced to make much tougher decisions about who, what, and how cuts will be distributed” (Levine, 1980a, p. 309). Additionally, as often experienced in government organizations, there are few rewards or incentives for conserving resources, because of incremental budgeting practices.

## **H. CONCLUSION**

Our review of the scholarly literature and research established a foundation for understanding fiscal stress, the causes of financial retrenchment, influential factors affecting retrenchment strategy and tactics, and the challenges of financial retrenchment management.

Fiscal stress involves pressure of balancing revenue with demand for expenditures. The type of fiscal stress upon an organization is linked to four categories of scarcity: relaxed scarcity, implying sufficient resources to support growth; chronic scarcity, implying limited growth; acute scarcity, implying an inability to support incremental growth; and total scarcity, implying an inability to provide baseline requirements. DoD is exhibiting acute fiscal stress.

Identifying which category accurately defines the fiscal condition of DoD required determining how its budget authority changed when measured in terms of current and constant dollars. Richard Rose (1980) outlined four ways public expenditure



could change when measured in this manner. They are (1) actual increases, (2) cuts without qualification, (3) spending squeeze, and (4) deflationary windfalls. DoD is exhibiting a cut without qualification.

Determining the cause of fiscal stress was necessary because it affects retrenchment strategies and tactics, and facilitates identifying comparative organizations. Levine asserted that scarce resources are usually the underlying factor necessitating an organizational change and these changes occur primarily in response to internal or external conditions resulting from political, economic, and/or technical factors. The specific causes were categorized by four types: problem depletion, environmental entropy, political vulnerability, and organizational atrophy. DoD is exhibiting fiscal stress caused by the external factors of problem depletion and environmental entropy.

Understanding the type and cause of fiscal stress, this literature review then examined strategies and tactics used by financially retrenched organizations. Brook's categorizations of resist, delay, minimize and manage strategies form the basis of this examination into financial retrenchment choices. These retrenchment choices, identified in Chapter IV's data examination, are ultimately being presented within a three-sector framework associated with the strategy and tactic to which it corresponds.

This project's three-sector matrix focuses specifically on financial choices designed to strategically minimize and manage retrenchment, because DoD is legislatively required to administer forthcoming budget cuts in accordance with the BCA of 2011. Thus, DoD exhibits minimize and management strategies and tactics that produce financial choices designed to deal with its retrenchment.

These choices produce significant expenditure reductions and have long-term effects upon organizational effectiveness. Resultantly, there are many challenges facing DoD managers as they make difficult financial retrenchment choices. These financial retrenchment choices are therefore worthy of comparison to the historical choices of comparable government, quasi-government, and publicly traded organizations in order to determine if DoD's choices are characteristic of an organization under similar fiscal stress.

Chapter III will discuss the characteristics sought in a comparative organization. Subsequently, the selected organizations are presented along with a discussion of their similarities and differences to the stated characteristics and will close with acknowledgements of our research limitations.

### **III. COMPARATIVE GOVERNMENT, QUASI-GOVERNMENT AND PUBLICLY TRADED ORGANIZATIONS**

This report seeks organizations spanning government, quasi-government, and publicly traded sectors to examine similarities and differences in financial retrenchment choices and compare their choices to the DoD's. The intent of this chapter is to establish and define the characteristics of reasonably comparative organizations, identify comparable organizations, discuss their similarities and differences to the stated characteristics, and acknowledge the limitations of this comparison.

#### **A. COMPARATIVE ORGANIZATIONS—CHARACTERISTICS**

It is necessary to define characteristics associated with other government, quasi-government, and publicly traded organizations that compare to the DoD and its current fiscal environment. These characteristics enable the selection of suitable comparative organizations whose financial retrenchment choices can then be analyzed and ultimately compared to those of the DoD.

Drawing on the literature of the previous chapter, we identify four characteristics. The first two characteristics address the fiscal environment and identify organizations experiencing real, not perceived, fiscal stress. These are (1) the type and cause of fiscal stress and (2) the duration of fiscal stress.

The final two characteristics address an organization's response to fiscal stress and the autonomy the organization has to manage the stress. This identifies organizations, bound by similar constraints, whose responses pursue comparative strategies. These are (3) the strategic response of the organization and (4) the amount of autonomy an organization has to manage fiscal stress.

These characteristics enable us to select suitable comparative organizations whose financial retrenchment choices can be analyzed and ultimately compared to the DoD.

## **1. Type/Cause of Fiscal Stress**

Management's retrenchment choices are affected by the type and cause of fiscal stress (Levine, 1980b; Schick, 1980). Therefore, the type and cause of fiscal stress are important factors governing how an organization responds to fiscal stress. The type of fiscal stress is defined by the level of scarcity associated with available funds. Funding scarcity could be relaxed, chronic, acute, and total (Schick, 1980). The cause of fiscal stress could be the result of internal or external conditions that arise from political, economic and/or technical factors. Resultantly, they can be categorized into four types: problem depletion, environmental entropy, political vulnerability, and organizational atrophy (Levine, 1980b).

The DoD exhibits acute fiscal stress caused by external factors of problem depletion and environmental entropy. Termination of the Iraq and Afghanistan wars, coupled with the nation-wide economic recession of 2008, placed downward pressures on the federal budget as expenditures exceedingly surpassed revenues and deficits became unsustainable. Resultantly, the BCA established discretionary spending caps, necessitating the DoD cut \$500 billion between FY 2013–2022. Challenged by financial retrenchment, the DoD must now make choices within the framework of a new fiscal reality and fewer resources, as available resources are insufficient to cover the incremental rise in program costs. Therefore, comparative government, quasi-government, and publicly traded organizations should exhibit acute fiscal stress resulting from external factors.

## **2. Duration of Fiscal Stress**

The expected duration of fiscal stress influences an organization's choice of strategy and tactics. The selected financial retrenchment strategy may be discrete or, if the duration of retrenchment increases, sequential as the organizations attempts to progressively manage retrenchment.

The BCA of 2011, and the continued prospect of sequester, directly contribute to DoD's fiscal outlook by legislatively reducing budget authority \$500 billion between FY

2013–2022. Thus, comparative government, quasi-government, and publicly traded organizations should exhibit fiscal stress with a realistically expected multi-year duration.

### **3. Strategic Response**

Organizations, faced with retrenchment, may choose to resist, delay, minimize or manage fiscal stress. The strategic response does not need to be discrete. An organization's response may employ one or more strategies simultaneously or progressively as retrenchment proves more severe.

DoD has sequentially responded to fiscal stress and now exhibits financial retrenchment choices designed to fulfill minimization and management strategies. Specifically, DoD used minimization tactics on March 1, 2013, when sequestration mandated a \$37 billion reduction to DoD's current year budget. Now, DoD is compelled to manage a 10-year BCA requirement to reduce budget authority by \$500 billion. Therefore, comparative government, quasi-government and publicly traded organizations should exhibit financial retrenchment choices intended to fulfill minimization and management strategies.

### **4. Autonomy**

DoD does not have complete autonomy. Because DoD is an agency within the U.S. federal government, DoD cannot raise revenue. It does reserve the ability, and duty, to request additional funding from Congress when unable to meet agency objectives. However, this does not constitute the autonomy associated with independently raising revenue through taxation, borrowing or inter-governmental transfers.

DoD, therefore, focuses on expenditure management during times of financial retrenchment. Controlling expenditure spending is the primary manner in which DoD can comply with program ceilings and targets that originate from austere financial environments. Resultantly, comparative government, quasi-government, and publicly traded organizations should exhibit financial choices designed to limit expenditure spending as a result of their fiscal environment.

Consequently, we seek comparative government, quasi-government and publicly traded organizations exhibiting multi-year acute fiscal stress resulting from external factors to which organizations are demonstrating financial retrenchment choices designed to fulfill minimization and management strategies.

## **B. COMPARATIVE ORGANIZATIONS—DOCUMENT REVIEW**

This section presents the organizations identified as comparable and examines their similarities and differences to the stated characteristics.

### **1. Government Organizations**

Government organizations are numerous and varied. They exist domestically and internationally. They can comprise several echelons, such as federal, state, or municipal. Echelons themselves contain agencies, departments, or offices that perform functions requiring financial support. For this report, we selected U.S. state governments for the purpose of examining their financial retrenchment choices and comparing them with the DoD.

#### ***a. Why the United States?***

Selecting government organizations within the United States improves the likelihood that social, economic, and political systems are comparable to DoD's operating environment. Furthermore, when external factors, such as problem depletion and environmental entropy, affect the United States government there is a considerable probability that other U.S. government organizations are influenced due to the dominant fiscal and political position of the federal government. Finally, people of the same social and political dynamics, when faced with financial retrenchment, are likely to respond with financial choices that are bound by and reflect their social, economic, and political systems.

#### ***b. Why State Level Government?***

State government organizations are selected because of the size and the reach of their budgets, the extensive political considerations influencing their budgets,

and how both combine to affect the financial retrenchment choices of decision makers. Additionally, because most state governments seek to maintain a balanced budget, there are increased prospects that strategies and tactics to reduce expenditure spending will be adopted during times of multi-year acute fiscal stress.

DoD's discretionary budget is the largest of all government agencies. Office of Management and Budget's (OMB) 2012 National Defense budget was \$669.6 billion in constant dollars, representing approximately 56 percent of the U.S. federal government's discretionary spending in 2012 (OMB, 2013a). Resultantly, DoD operations, assets, and contracts are diverse and have considerable effects upon the U.S. economy.

State governments have sizable budgets, economies, and populations along with a broad spectrum of agencies and programs. Formulation of state government budgets garners substantial political consideration because budgets reflect the political priorities of an organization and affect its population and economy. Thus, the political, economic and social factors surrounding financial retrenchment choices, and the effects stemming from them, significantly influence decision-makers. Because the ultimate objective is to examine financial retrenchment choices of comparative organizations to those of DoD, selecting government organizations whose decision makers face similar political, economic, and social pressures is significant.

Finally, states have full autonomy to raise revenue through taxation, borrowing or intra-government transfers. However, most states exhibit a balanced budget requirement. Therefore, the probability exists that expenditure spending reductions will be implemented in times of acute fiscal stress.

*c. Why California (2010), Massachusetts (2009), and New Jersey (2010)?*

In Arnett's 2012 analysis of measures and responses of U.S. states to fiscal stress, Comprehensive Annual Financial Reports (CAFR) of all 50 states were used to build four financial indexes measuring fiscal stress upon a state government's budget (Arnett, 2012). These financial indexes measured cash solvency, budget solvency, long-

run solvency, and service-level solvency (Arnett 2012; Groves, Godsey, & Shulman, 1981; Wang, Dennis, & Tu, 2007).

Cash solvency reflects the level of current assets available to cover current liabilities or simply a “government’s ability to generate enough cash or liquidity to pay its bills” (Groves et al., 1981, p. 6). Budget solvency reflects a government’s “ability to generate sufficient revenues over its normal budgetary period to meet its expenditure obligations and not incur deficits” (Groves et al., 1981, p. 6). Long-run solvency reflects the “long-run ability of a government to pay all the cost of doing business, including expenditure obligations that normally appear in each annual budget, as well as those that show up only in the years in which they must be paid” (Groves et al., 1981, p. 6). Finally, service-level solvency, which is a composite of tax, revenue, and expense per capita ratios, reflects “whether a government can provide the level and quality of services required for the general health and welfare of a community” (Groves et al., 1981, p. 6).

Using data collected from 2009 CAFRs, Arnett found seven out of 50 states exhibited high amounts of fiscal stress across all four solvency index ratios (Arnett, 2012, p. 100). These were California, Connecticut, Delaware, Hawaii, Massachusetts, New Jersey, and New York. Of these states, California, New York, and Massachusetts had the largest FY 2009 state general funds (National Association of State Budget Officers [NASBO], 2009). California, New York, and New Jersey are among the highest populations (U.S. Census, 2010). Consequently, California, New York, New Jersey, and Massachusetts’ 2009 CAFRs were examined against the characteristics required of a comparative government organization.

This examination revealed that all four states exhibited multi-year acute fiscal stress resulting from external factors. However, California and New York did not demonstrate financial retrenchment choices designed to fulfill minimization and management strategies in 2009. Therefore, an examination of California and New York’s 2010 CAFRs was performed. This examination revealed both states continued to exhibit multi-year acute fiscal stress. However, in 2010, California demonstrated financial retrenchment choices designed to fulfill minimization and management strategies while



New York did not. Therefore, we selected California (2010), Massachusetts (2009), and New Jersey (2009) for comparative analysis.

*d. California (2010)*

(1) Similarities to stated criteria. California exhibited multi-year acute fiscal stress resulting from external factors. The state reported continued job losses in FY 2010 with the unemployment rate reaching a high of 12.6 percent in March 2010. The state reported a decrease in tax revenue of nearly \$2.9 billion. Revenue from personal income taxes had decreased \$1.6 billion and corporation tax revenue decreased \$1.3 billion. The state's "General Fund ended the FY with assets of \$12.9 billion, liabilities of \$32.5 billion, and fund balance reserves of \$1.3 billion, leaving the general fund with an unreserved fund deficit of \$20.9 billion" (State of California, 2010a, p.15). California reported that its financial condition was the result of the 2008 nation-wide recession and its own weakened economy (State of California, 2010a).

California's financial choices did limit expenditure spending, albeit modestly. General fund expenditures were decreased by \$5.4 billion. Program budgets whose General Fund support was cut include K–12 education, corrections, public assistance, and Medicaid.

(2) Differences to stated criteria. California, despite modestly limiting its expenditure spending, used its autonomy to a great extent. Solutions included new federal funding, short-term tax increases, loans, transfers, and funding shifts (State of California, 2010a).

California also exhibited fiscal stress resulting from internal factors. The California Public Employees' Retirement System has a large unfunded liability and federal and state maintenance-of-effort requirements and other legal constraints increased costs and substantially restricted budgeted programs that could be reduced (State of California, 2010a).

*e. Massachusetts (2009)*

(1) Similarities to stated criteria. Massachusetts exhibited multi-year acute fiscal stress resulting from external factors. The state reported a decrease in tax revenue of nearly \$2.7 billion. This was the result of decreased income tax payments, sales, and use taxes. “Because of the drop in tax revenues, the Commonwealth ended the year with a nearly \$1.4B structural deficit” (Commonwealth of Massachusetts, 2009, p. 34). Massachusetts reported that its financial condition was the consequence of the deepening nation-wide recession resulting from problems in the subprime mortgage and other credit markets (Commonwealth of Massachusetts, 2009).

Massachusetts was required to close a budget gap of \$479 million resulting from the projected decrease in expected tax revenue. Expenditure reductions were also limited another \$943 million by in-year budgetary reductions. These reductions affected direct local aid, state pensions, earmarks, transportation, health and human services, and subsidies to authorities.

(2) Differences to stated criteria. Massachusetts, to alleviate strain on programs and services, used its autonomy to draw funds from reserve accounts, acquire additional federal stimulus funding and commercially borrow. Massachusetts also employed resists tactics, specifically budget gamesmanship.

*f. New Jersey (2010)*

(1) Similarities to stated criteria. New Jersey exhibited multi-year acute fiscal stress resulting from external factors. The State’s budgeted revenue experienced a significant decline of \$3.5 billion from its originally adopted budget (State of New Jersey, 2009). The state reported an unemployment rate of 10.1 percent, declining personal income rates, a 20 percent decline in motor vehicle registrations, and a depressed housing sector; all of which affected General Fund revenues and reflect the economic recession. Both national and local economic factors were attributed for the decline (State of New Jersey, 2009).

New Jersey is constitutionally required to maintain a balanced budget. Consequently, there were significant budget cuts proposed by the government

and the eventual financial choices did limit expenditure spending. As a budgeting practice, the state budgets as though it will receive maximum federal grant dollars into its General Fund. Therefore, it administered budget reductions to eight department and programs when there was a \$2 billion shortfall in federal grant funding.

(2) Differences to stated criteria. New Jersey exercised its autonomy to acquire additional federal stimulus funding and used dedicated reserve funding to ensure the General Fund remained solvent in FY 2009.

New Jersey also exhibited fiscal stress resulting from internal factors. “The state had not fully funded its pension plans for several years” (State of New Jersey, 2009, p. 5). As of June 2008, this underfunding, coupled with investment decline, led to an unfunded accrued liability for state and local pension plans of \$34.4 billion and an Other Post-employment Benefit unfunded accrued liability of \$55.9 billion (State of New Jersey, 2009).

## **2. Quasi-Government Organizations**

Quasi-government organizations “possess legal characteristics of both the government and private sectors” (Moe, 2001, p. 290). Quasi-government organizations are intended to offer strategic products or services the government deems necessary for the greater public good. They typically consist of natural monopolies, such as energy, postal services, railways, and telecommunications.

There are many kinds of quasi-governmental or hybrid organizations with varying degrees of legal and behavioral characteristics. Moe (2001) categorized them as (1) quasi-official agencies, (2) government-sponsored entities, (3) federally funded research and development corporations, (4) agency-related nonprofit organizations, (5) venture capital funds, (6) congressionally chartered nonprofit organizations, and (7) instrumentalities of indeterminate character.

The United States Postal Service (USPS) and National Railroad Passenger Corporation (Amtrak) are quasi-official agencies that are afforded “considerable autonomy from regular lines of accountability to central managerial agencies as well as to

the General Accountability Office (GAO). It is not, however, as is often argued, protected from political influences” (Moe, 2001, p. 293).

USPS and Amtrak were selected for comparative analysis based on their similarities to the DoD in exhibiting multi-year acute fiscal stress resulting from external factors to which the organization is demonstrating financial retrenchment choices designed to fulfill minimization and management strategies.

*a. United States Postal Service (USPS)*

(1) Similarities to stated criteria. The USPS exhibited multi-year acute fiscal stress resulting from external factors. “As the USPS’s finances have deteriorated, its ability to absorb operating losses has been diminished. Between FY 2005 and FY 2011, the USPS’s debt rose from \$0 to \$13 billion” (Kosar, 2012, p. 2). Additionally, the USPS faces rising costs associated with its manpower intensive workforce, retiree benefits, pensions, and health care. In 2008, the USPS’s net profit margin eroded as customers continued to increase internet accessibility and chose it as a preferred means of communication and business. Thus, as revenues decreased, fixed costs became unsustainable. “Looking forward, the USPS projects that, absent additional action, annual financial losses will escalate over the next decade to \$33 billion in fiscal year 2020” (Government Accountability Office [GAO], 2010, p. 12).

The USPS must rely heavily on expenditure management to achieve fiscal solvency. The USPS’s expenditure management options include reduction of the Postal Accountability and Enhancement Act (PAEA) mandated Postal Service Retiree Health Benefits Fund (PSRHBF) payments, pension costs, contributions toward employee health care premiums and life insurance, retail and nonretail facilities, and mail delivery service, as well as increasing the USPS’s power to control labor costs (Kosar, 2012). Strategically, the USPS has demonstrated financial retrenchment choices designed to fulfill minimization and management strategies.

The USPS lacks autonomy in its ability to raise revenue and reduce expenditures. Prior to 1971, Congress provided annual appropriations to the U.S Post Office Department (USPOD) and was heavily involved in routine operations such as the

selection of managers and pricing of postal services. In 1970, the Postal Reorganization Act (PRA), made the USPOD an “independent establishment of the executive branch” (39 U.S.C. § 201), renaming it the USPS. Today, the USPS continues to receive an annual appropriation of approximately \$100 million, approximately 13 percent of its operating budget. This reorganization reduces congressional oversight but did not eliminate it. The PRA also established the Postal Rate Commission to oversee postal operations, set mail rates, and hold hearings to approve USPS proposed mail classification or scope of service changes (Kosar, 2012), thereby limiting the USPS’s autonomy.

(2) Differences to stated criteria. The USPS differs from DoD in its ability to generate revenues, borrow money from the U.S. Treasury, and its requirement to prefund retiree benefits. Although USPS was designed to be self-sustaining, its ability to expand or reduce products and services in response to market trends is hampered by federal law. In an attempt to delay or alleviate its cash shortage, USPS requested a reduction and deferral of the PAEA mandated PSRHBFF payment, which required “USPS to prefund its future retirees’ health benefits at a cost of approximately \$5.6 billion per year for 10 years” (Kosar, 2010, p. 3). Additionally, USPS attempted to offset its operating losses by borrowing \$3 billion a year, within a statutory debt limit of \$15 billion.

***b. National Railroad Passenger Corporation (Amtrak)***

(1) Similarities to stated criteria. Amtrak exhibited multi-year acute fiscal stress resulting from external factors. Amtrak

has been in a shaky financial condition ever since it was created by the federal government more than 30 years ago. Although Amtrak was established as a private, for-profit company, it has needed—and received—federal subsidies every year since it began providing service in 1971. (Congressional Budget Office [CBO], 2003, p. iii)

Both passenger and freight rail have experienced long-term acute fiscal stress because of “a significant decline in market share by the middle of the 20<sup>th</sup> century as travelers and shippers turned increasingly to airlines, trucks, and automobiles

to meet their transportation need” (CBO, 2003, p. xi). Additionally, “Amtrak’s data show that only one of the railroad’s 40 routes covers all its operating costs. For the remaining 39 routes, Amtrak loses an average of \$53 for each passenger” (Scheinberg, 1998, p. 7).

Amtrak has demonstrated financial retrenchment choices designed to fulfill minimization and management strategies. Financial retrenchment tactics include reduced staffing, deferred maintenance programs, reduced inventory, and reduced frequency or elimination of unprofitable routes.

Amtrak lacks significant autonomy, as it is highly regulated by Congress. Legislative provisions “created a politically appointed board of directors, emphasized a nationwide rail system, preserved expensive compensation provisions for laid-off workers, and forced Amtrak to provide discounted fares for people with disabilities” (CBO, 2003, p. x). The Interstate Commerce Commission also complicated matters when it implemented rigid regulation that virtually eliminated Amtrak’s ability to adapt to changing market conditions (CBO, 2003). When Amtrak proposed discontinuing service in unprofitable routes, the organization encountered opposition by “a range of interests to see passenger train service continued in potentially affected communities” (Scheinberg, 1998, p. 7).

(2) Differences to stated criteria. Amtrak was intended to be a self-sustaining for-profit organization. As a quasi-official agency, it can raise revenue and borrow money for capital investments. Additionally, Amtrak receives subsidies and grants, including \$2.2 billion from the Taxpayer Relief Act of 1997.

The USPS and Amtrak were two organizations, of substantial size and complexity, that met the stated characteristics for comparative analysis. Both displayed multi-year acute fiscal stress and financial retrenchment choices designed to fulfill minimization and management strategies.

### **3. Publicly Traded Organizations**

This report selects publicly traded firms headquartered within the United States for the purpose of examining their financial retrenchment choices and comparing them with the DoD.

**a.      *Why the United States?***

Publicly traded firms are owned and operated by private citizens. However, government regulation often impacts organizational operations and financial choices. Thus, selecting firms within the United States improves the likelihood of a comparable socioeconomic and political environment.

**b.      *Why Fortune 500 Companies?***

The DoD's FY 2013 discretionary budget was approximately \$527.5 billion (OUSD[C]), 2013b, p. A-7). Therefore, in this project, seeks publicly traded companies with substantial size and complexity. Forbes Fortune 500 lists publicly owned companies, all of which have annual revenues in the billions of dollars. These companies are also required by government regulation to publish comprehensive financial records. These records provide comprehensive financial information for data examination.

**c.      *Why Ford and IBM?***

Both Ford and IBM are publicly traded firms based in the United States that are of sufficient size and complexity. These firms also exhibit multi-year acute fiscal stress caused by external factors. In their response to fiscal stress these companies demonstrated financial retrenchment choices designed to fulfill minimization and management strategies.

**d.      *Ford Motor Co***

(1) Similarities to stated criteria. Ford exhibited multi-year acute fiscal stress resulting from external factors. These factors include fierce international competition and the 2008 nation-wide recession. Table 2 shows the total percent of automotive shares during 1995—2011. As indicated, international competition severely eroded Ford's market share from its high of 26 percent in 1995 to a 14 percent low in 2008. The 2008 nation-wide recession continued to worsen Ford's fiscal condition, when sales plunged 32 percent to their lowest level in 25 years (George, 2012, p. 2).

	2011	2010	2009	2008	2007	2006	2005	2000	1995
GM	18	19	20	22	23	24	26	29	33
<b>Ford</b>	16	16	15	14	15	17	18	24	26
Toyota	13	15	17	16	16	15	13	9	7
Honda	9	10	11	10	9	9	8	7	5
Chrysler	11	9	10	11	12	13	13	14	15
Nissan	8	8	7	7	6	6	6	4	5
Hyundai	5	4	4	3	3	3	2	1	1
Kia	3	3	3	2	2	2	1	0	0
VW	2	2	2	2	2	2	1	2	1
BMW	2	2	2	2	1	1	1	1	0.5
Others	9	9	7	7	7	6	6	8	6
%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Compiled from S&P Industry Surveys, “Auto Sales, Market Data Center,” Wall Street Journal, Nov 1, 2011.

Table 2. Percentage of Automotive Share 1995–2011 (from Shein & Bell, 2012)

Ford demonstrated financial retrenchment choices designed to fulfill minimization and management strategies. In 2002, the company cut approximately 20,000 jobs and closed numerous plants. Four years later, Ford launched a major restructuring plan which cut an additional 30,000 jobs and put 14 plants worldwide in idle status over the next six years. Ford made significant efforts to cut vehicle development costs by “engineering a car once to serve multiple markets worldwide” (Shein & Bell, 2012, p. 4).

(2) Differences to stated criteria. Ford is more autonomous in its ability to respond to fiscal stress than the DoD. Ford raised \$23.6 billion in financing from bankers and investors while mortgaging company assets to include its iconic brand logo (Johnson & Krisher, 2008). However, Ford’s autonomy is limited by its fiduciary responsibilities to stockholders, government regulations, and union contracts. Ford’s ability to raise capital is also limited by its credit rating, leverage ratios, and the cost of capital. Therefore, in times of acute fiscal stress, it is likely that cost cutting measures will result in a reduction to expenditure spending as managers make retrenchment choices designed to fulfill minimization and management strategies.

Ford also exhibits acute fiscal stress resulting from internal factors. The United Autoworkers Union’s (UAW) significant power and influence limit Ford’s ability to control and adjust labor costs. By 2009, the UAW’s salaries and benefits were significantly above industry average and unsustainable. “The Big 3 paid employees



\$73.21 per hour, inclusive of benefits compared to \$44.17 for Japanese makers” (Sherk, 2008). Legacy costs to include retiree lifetime benefits in the form of pensions, life insurance, unemployment benefits, and disability payments also drove up labor costs (Taylor, 2007).

*e. International Business Machines (IBM)*

(1) Similarities to stated criteria. IBM exhibited multi-year acute fiscal stress resulting from external factors. In the mid-1980s, IBM was an established company that produced well regarded and universally recognized mainframe computing products. However in 1984, customer demand shifted from large mainframe computers to networked mobile personal computers. The result was a multi-year decline in sales, assets, and equity. Competitors developed and introduced new technologies that dramatically impacted IBM’s revenue. Revenues dropped 146 percent in 1991, 60 percent in 1992, and another 60 percent in 1993 (Applegate, Austin, & Collins, 2009, p. 3). The major cause of this multi-year fiscal stress was environmental entropy, as IBM’s mainframe business became obsolete and competitors successfully marketed emerging technologies.

IBM demonstrated financial retrenchment choices designed to fulfill minimization and management strategies. The company cut costs in small and large ways with both short and long-term effects to remain solvent. In early 1993, IBM had initiated a \$3.7 billion restructuring plan resulting in the elimination of 40,000 jobs.

(2) Differences to stated criteria. A major difference to the stated characteristics is IBM’s autonomy. IBM is able to raise revenue through the issuance of stocks, bonds, and loans. IBM also has the ability to freely divest underperforming subordinate units from its business portfolio.

**C. COMPARATIVE ORGANIZATIONS—LIMITATIONS**

There are limitations associated with finding comparative organizations because of the size and complexity of the DoD. The DoD’s budget, its global presence, and its economic influence make it a uniquely large and complex organization. The DoD varies

in different ways from each of the comparable government, quasi-government, and publicly traded organizations.

#### **D. CONCLUSION**

In Chapter III, we defined comparable characteristics of government, quasi-government, and publicly traded organizations and identified the similarities and differences of each to the stated criteria. The chapter closed with an acknowledgement of research limitations.

In Chapter IV, we identify financial retrenchment choices and associate them with a retrenchment strategy and tactic. Then a three-sector analytical framework is developed and the data incorporated for analysis. The chapter concludes with a presentation of results.

## **IV. ANALYTICAL FRAMEWORK**

In this chapter, financial retrenchment choices are identified and associated to a retrenchment strategy and tactic. Then a three-sector analytical framework is developed and the data incorporated for analysis. The chapter concludes with a presentation of results.

### **A. COMPARATIVE ORGANIZATIONS—DATA EXAMINATION**

Having selected suitable comparative government, quasi-government and publicly traded organizations, we examine their financial retrenchment choices. This section provides data examination of the key financial retrenchment choices of comparable government, quasi-government, and publicly traded organizations. The financial retrenchment choices are presented and associated to a retrenchment strategy and tactic. The next section develops a three-sector analytical framework to which the data is incorporated and analyzed.

#### **1. Government Organizations**

##### ***a. People***

(1) Financial retrenchment choices: minimize. California utilized furloughs and restructured the work week. The state extensively used this tactic in 2009 and continued it into 2010 when state workers were ordered to take three unpaid days off per month until the 2010 budget was in place at an unspecified time. The action was expected to affect 150,000 state workers and save \$150 million a month. Also, the governor attempted to cut two state holidays, eliminate time and a half for holiday workers and offer four-day work weeks with 10-hour work-days.

Massachusetts utilized furloughs as short-term financial retrenchment choices. The state furloughed 5,000 executive branch employees for up to five days. The state also sought additional furlough concessions from union workers in order to prevent additional layoffs.

New Jersey continued a hiring freeze in 2009 and implemented furloughs. “Over the past two years, through attrition and an ongoing hiring freeze, the state, reduced the size of the state workforce by nearly 2,000 positions” (State of New Jersey, 2008, p. 3). Then in May of 2009, the New Jersey governor issued a series of one-day closures affecting 36 departments and agencies in an effort to help close a \$4.4 billion budget shortfall (Hester, 2009).

California, Massachusetts and New Jersey’s financial retrenchment choices demonstrate tactics designed to minimize the effects of financial retrenchment. These organizations reduced expenditures by implementing hiring freezes and furloughs. These tactics were short-term, immediately produced savings, and were intended to avert more drastic cuts to the workforce.

(2) Financial retrenchment choices: manage. California utilized work force reductions and restructured pay and benefits for state employees. The state implemented a five percent workforce reduction to achieve \$449.6 million in savings (State of California, 2010c). The 2010 budget reduced state employee salaries another five percent following atop a ten percent decrease the previous year. Furthermore, comprehensive pension reform was achieved through collective bargaining and legislation. This increased the full benefits retirement age for most new employees, increased employee contributions towards pensions, and ended pension spiking (State of California, 2010c).

Massachusetts utilized work force reductions and restructured pay and benefits for state employees. Between 2008 and 2009, 4,200 state workers attrited or were cut with 2,300 of those losses coming in 2009 alone. Furthermore, state workers’ health insurance contributions were changed from a system based on date of hire to one based on salary levels and affordability, thereby saving \$51 million.

New Jersey utilized work force reductions, offered early retirements, and restructured pay and benefits for state employees. The 2009 state budget attempted to save \$350 million through a workforce reduction of 3,000 personnel and implementation of an Early Retirement Incentive Program (State of New Jersey, 2009). Finally, “the state raised the retirement age for new employees from 55 to 60, increased

pension contributions, and capped the defined benefit pension for new employees (State of New Jersey, 2009, p. 4).

California, Massachusetts, and New Jersey's financial retrenchment choices demonstrate tactics designed to manage the effects of financial retrenchment. These organizations reduced their workforces over the course of the year and restructured pay and benefits. New Jersey also implemented early retirements. These tactics were slower at harvesting savings than hiring furloughs. They also have longer-term effects upon the organization and its employees.

During the time period covered by this project, leadership changes were noted in California and New Jersey. However, no connection can be established which associates the leadership change to a financial retrenchment choice. California's incumbent governor, in particular, was constitutionally prevented from seeking a third term. Thus, a leadership change was not the result of a financial retrenchment choice. In both states, new governors were appointed through general election, not special election resulting from the fiscal condition of the state. Therefore, these leadership changes will not be reflected in the three-sector matrix.

***b. Performance***

(1) Financial retrenchment choices: minimize. California cut programs and tried to burden share the effects of fiscal stress with federal and local governments. The state also attempted to eliminate non-essential services and programs. The final budget saved some programs, but still removed their funding for 2010. Also, California sought to burden share by seeking reimbursement from the federal government for funding owed to the state, along with its fair share of federal funding under the American Recovery and Reinvestment Act. California also reduced funding to local governments to balance its budget.

Massachusetts cut programs, centralized decision-making, highlighted small efficiency improvements, and tried to burden share with local governments. Multiple non-essential programs were cut or their funding was removed. Decision-making was centralized in multiple departments, mostly through the

consolidation of funding accounts, to provide department heads budget flexibility. The state's budget highlights numerous small efficiency and productivity improvements, many not yet realized, and takes credit for their savings. Most efficiency gains were simple realignments of responsibilities, as well as funding, decision-making, or technological improvements. Finally, Massachusetts burden shared by reducing aid to local municipalities, but offset the effect by granting additional authorities to municipalities.

New Jersey cut programs, highlighted small efficiency improvements, centralized decision-making, and attempted to burden share with local municipalities. Program cuts targeted multiple non-essential programs. For example, New Jersey realized \$1.1 million in savings by eliminating the Mobile Unit from the Motor Vehicle Commission acknowledging that customers arrange their own transportation to scheduled appointments. Minor efficiency improvements included the consolidation of 911 call centers, office supply control programs, and the reduction of outsourced website maintenance. Finally, New Jersey reduced the level of aid to municipalities by \$162 million (State of New Jersey, 2009).

California, Massachusetts, and New Jersey's financial retrenchment choices demonstrate tactics designed to minimize the effects of financial retrenchment. These organizations sought small efficiencies, cut non-essential programs, centralized decision-making, and shared the burden of retrenchment. These tactics immediately produced savings with very little impact upon the organization. They were also intended to avert or reduce other more significant cuts to programs and services.

(2) Financial retrenchment choices: manage. In 2010, California did not exhibit any long-term financial retrenchment choices that addressed performance tactics. There was no organizational restructuring, reduction in capital assets, privatization actions, large scale efficiency improvements or long-term transformation efforts. California focused on short-term tactics, discussed previously, and did not attempt to realign, transform, or restructure government in order to combat long-term financial retrenchment or avert future crisis.

Massachusetts implemented organizational restructuring to gain efficiencies. It converted county sheriffs into state sheriffs, and consolidated numerous independent transportation bureaus into the Massachusetts Department of Transportation.

New Jersey conducted organizational restructuring and eliminated two cabinet level agencies—the Department of Personnel and the Commerce Commission—and consolidated the essential functions of those agencies into other Executive Branch departments or agencies (State of New Jersey, 2009).

Massachusetts and New Jersey organizationally restructured, thereby demonstrating one performance-related tactic designed to manage the effects of financial retrenchment. In both states, this tactic was slow to enact, and thus produce savings. Cuts and realignments of this magnitude required legislative approval, and both met with resistance. In the process, New Jersey’s legislature spared a third, cabinet-level agency from elimination. This illustrates difficulty in implementing long-term retrenchment choices within a dynamic organization.

*c. Budget*

(1) Financial retrenchment choices: minimize. California targeted cuts and delayed spending as short-term financial retrenchment budget choices. Subject to constitutional, statutory, and court-ordered spending requirements, almost every program’s funding was reduced in FY 2010. Also, California attempted to delay spending by extending the repayment date of \$231 million in loans to the State Highway Account (State of California, 2010d).

Massachusetts targeted cuts, attempted to defer maintenance on government facilities, used performance metrics, and renegotiated contracts as short-term financial retrenchment budget choices. Targeted cuts included elimination of \$40 million in earmarks. Also, 190 line items were held to their baseline, while others were targeted for investment. The state attempted to defer maintenance by reforming its maintenance model for state facilities. The new model funded only urgent repairs and deferred avoidable maintenance. Finally, performance metrics and contract renegotiation were

used, as the state expanded its Medicaid pay-for-performance initiatives and renegotiated prescription drug contracts to promote less costly generic prescription medications.

New Jersey targeted cuts and renegotiated contracts. Funding cuts targeted many programs, including higher education, hospitals, arts, history, and tourism. However, mental health services, New Jersey's transit system, and state renal assistance programs were not affected. Renegotiated contracts included the state's natural gas supply contract, an action that recognized \$4.1 million in cost avoidance over three years. New Jersey also sought a new provider for workers' compensation managed care services, and centralized its system for evaluating contractors to avoid repeatedly hiring poor performing vendors.

California, Massachusetts, and New Jersey's financial retrenchment choices demonstrate tactics designed to minimize the effects of financial retrenchment. These organizations implemented targeted budget cuts, renegotiated contracts, focused on performance, and deferred maintenance. These tactics immediately produced savings with minimal impact upon the organization's workforce and infrastructure. Targeted cuts did affect programs and services, but because they were not across-the-board cuts they could be administered in a way that minimized the effects. The savings produced by these tactics were meant to offset, or prevent more serious cuts with longer-term ramifications.

(2) Financial retrenchment choices: manage. California implemented spending freezes, leased back surplus property, and initiated a budget reform. The state implemented spending freezes, holding spending essentially flat compared to the prior year (State of California, 2010d). California then chose to lease back 11 office buildings "for a period of 20 years with first right of refusal if the properties are put up for sale" (State of California, 2010d, p. 23). This tactic recognized \$1.2 billion in revenue. Finally, California conceived of a constitutional amendment to substantially strengthen the state's rainy day fund in order to avoid future boom-and-bust cycles (State of California, 2010d). This budget reform, goes before voters in 2014, and, if passed, "will require more stringent deposit requirements in good budget years to provide a greater cushion for bad budget years" (State of California, 2010d, p. 2).



Massachusetts leased back golf courses previously managed by the Department of Conservation and Recreation. The state also restructured its budget by creating a transportation fund that directed transportation revenue to pay for all transportation-related expenses. This tactic was expected to bring transparency to state-wide transportation costs and show the extent to which transportation expenses actually need to be subsidized by the general fund.

New Jersey implemented a spending freeze, terminated or renegotiated leases on surplus property, and leveraged its buying power. The state froze spending at its current level for FY 2009 (State of New Jersey, 2009). Next, New Jersey consolidated staff into vacant state-owned facilities and saved \$5.1 million from the termination or renegotiation of 13 leases (State of New Jersey, 2009). Then, New Jersey joined the Western States Contracting Alliance to leverage its buying power and obtain lower vendor prices (State of New Jersey, 2009).

Finally, New Jersey restructured its budget through various legislative acts. The state created a long-term obligation and capital expenditure fund to limit the use of surplus accounts to fund long-term obligations in times of retrenchment. The governor issued an executive order requiring recurring revenues match recurring expenditures in future budget proposals. New Jersey also proposed a constitutional amendment that required public approval of new debt.

California, Massachusetts, and New Jersey's financial retrenchment choices demonstrate tactics designed to manage the effects of financial retrenchment. Commonly used tactics included spending freezes, leased back of surpluses property, and budget reform. These tactics took more time to implement than minimization tactics. Thus, they were slower in harvesting savings in the current year. However, once the tactics were implemented the states recognized significant saving over multiple years.

## **2. Quasi-Government Organizations**

### ***a. People***

(1) Financial retrenchment choices: minimize. USPS implemented hiring freezes on full-time employees and restructured its workforce. USPS created job flexibility by cross-training employees. “Changes in the skill requirements of some jobs and the needs of operations have made it more feasible and necessary for employees to be trained in different tasks and work in different areas, depending on daily needs” (GAO, 2010, p. 29). This gave managers the ability to fill vacancies, left by the hiring freeze, with other full-time employees already inside the organization.

Amtrak did not exhibit any financial retrenchment choices designed to minimize the effects of fiscal stress. There was no evidence of hiring freezes, furloughs, or workforce restructure.

USPS’s financial retrenchment choices demonstrate tactics designed to minimize the effects and financial burden placed on their workforce. Furloughs would have provided an immediate savings; however, USPS favored hiring freezes and created greater flexibility over employee assignments by restructuring the workforce.

(2) Financial retrenchment choices: manage. USPS utilized force reductions, restructured pay, benefits, and offered early retirements. Through personnel cuts, early retirements, and separation incentives designed to encourage voluntary attrition, USPS reduced nearly 21 percent of its employees—from 901,238 at the end of FY 2000 to 712,082 at the end of FY 2009 (GAO, 2010). The USPS also reduced entitlement obligations by hiring part-time employees to fill vacancies not filled by its remaining full-time employees. These new part-time hires also had a new two-tier pay system. The USPS also proposed a pay-as-you-go approach to funding retiree health benefit obligations.

Amtrak reduced its workforce by cutting management 10 percent. Amtrak also reduced passenger support and station staffing. Pay and benefits were also

restructured. Pay-as-you-go funding of retiree benefits was implemented and labor protection arrangements were eliminated.

The USPS and Amtrak's financial retrenchment choices indicate a strong reliance on management tactics designed to control long-term personnel costs. USPS was the only organization to offer early retirement options, but both used force reductions and restructured pay and benefits to reduce the organization's entitlement obligations.

***b. Performance***

(1) Financial retrenchment choices: minimize. USPS implemented small efficiency improvements tactics to minimize performance costs. To reduce delivery costs, USPS increased utilization of cluster boxes and expanded self-service kiosks.

Amtrak implemented small efficiency improvements, cut departments, burden shared and centralized decision-making. Small efficiency improvements include establishment of a reform board to identify improvement initiatives;

aligning dining car staffing with seasonal changes in customer demand; establishing metrics to assess service attendants' onboard sales performance; reducing spoilage; closely tracking onboard stock levels; regularly refreshing menus; and exploring new pricing and revenue management options to align with customer needs and enhance cost recovery. (National Railroad Passenger Corporation, 2013, p. 2)

Amtrak consolidated departments and centralized decision-making to better manage losses and identify cost savings. Specifically, Amtrak consolidated operations and accountability for its food and beverage into a single department. They also appointed a general manager responsible for long-distance services and route directors to oversee train profitability (National Railroad Passenger Corporation, 2013).

In its attempt to reduce maintenance and operations costs through burden sharing, Amtrak requested subsidies from states interested in maintaining passenger rail service in their cities.

While USPS only implemented one of the four performance minimization tactics, Amtrak maximized all options to achieve short-term results and savings. Organizations experiencing financial retrenchment usually are not the most efficient; therefore, performance minimization tactics are least challenging to implement.

(2) Financial retrenchment choices: manage. USPS requested Congressional approval to implement organizational restructuring options such as expansion of mail and express services, reduction of delivery from six days a week to five days, change in First-Class Mail standards from overnight to two-day delivery, and development or enhancements to expand postal products. Additionally, USPS implemented low-cost labor alternatives initiatives by decreasing full-time positions in favor of part-time and outsourced labor intensive services.

Amtrak implemented organizational restructuring, large-efficiency improvements, low cost labor alternatives, and strategic repositioning tactics. Specifically, Amtrak restructured into strategic business units and repealed the ban on outsourcing work. Large efficiency improvements include implementation of technology and automation, such as point of sale systems, to increase cashless sales onboard trains “aimed at improving customer service, automating financial and other reporting, and eliminating the error prone and time consuming method of manual data entry” (National Railroad Passenger Corporation, 2013, p. 2). Amtrak requested legislative approval for strategic repositioning initiatives such as expanding high-speed rail service into new geographic locations and cancelling service in unprofitable regions.

Again, Amtrak maximized all financial retrenchment options under performance management, while USPS used two of the four. Low-cost labor alternatives and organizational restructuring were used by both. Amtrak clearly preferred efficiency initiatives over financial retrenchment choices impacting their employees.

*c. Budget*

(1) Financial retrenchment choices: minimize. USPS deferred spending on capital investments and maintenance programs. USPS has historically

underfunded maintenance, “causing it to focus on ‘emergency’ repairs at the expense of routine maintenance” (GAO, 2010, p. 33).

“Amtrak took steps to conserve cash by reducing inventory, requiring advance payment for work that Amtrak performed for others, and delaying payments made to others by 15 days” (General Accounting Office [GAO], 1995, p. 35). Additionally, the organization reduced general overhead costs and deferred maintenance and capital investments. Amtrak strived to maintain a periodic preventive maintenance program and regular heavy overhauls on its locomotives and cars every three to four years, but lack of adequate funding led to the implementation of a “progressive maintenance program” (GAO, 1995, p. 45).

USPS and Amtrak’s financial retrenchment choices revealed little reliance upon budget minimization tactics. To achieve immediate savings, both organizations deferred spending and/or maintenance. Amtrak also used performance metrics.

(2) Financial retrenchment choices: manage. Declines in mail volume and increased automation resulted in costly excess capacity. “USPS has reported that it has 50 percent excess plant capacity in its First-Class Mail processing operations” alone (GAO, 2010, p. 30). As a result, GAO recommended USPS leverage leasing partnerships with retailers by establishing postal retail locations “within drug stores, grocery stores, and other retail chain stores, such as those in shopping centers and local malls” (GAO, 2010, p. 34). The USPS also reduced capital assets by closing selected mail processing facilities and streamlining field structure costs. “In fiscal year 2009, it closed 1 of its 9 area offices and 6 of its 80 district offices” (GAO, 2010, p. 38).

In an effort to reduce its operating loss, Amtrak sold real estate, other assets, and “right-of-way leases for telecommunications lines and mail and baggage service” (GAO, 1995, p. 96). They also refinanced assets.

Budget management tactics were USPS and Amtrak’s least used retrenchment strategy. Of the five general tactics, both sold and/or leased capital assets to reduce expenses.

### **3. Publicly Traded Organizations**

#### ***a. People***

(1) Financial retrenchment choices: minimize. After hiring a new CEO to recover the company, Ford implemented short-term hiring freezes and restructured its workweek to stem its personnel costs while more drastic longer-term solutions could be designed and implemented.

(2) Financial retrenchment choices: manage. Ford changed its leadership and hired Alan Mulally, who was largely credited with a successful turnaround at Boeing where he cut the workforce by more than half and shrunk turnaround for aircraft builds by 50 percent (Shein, 2012, p. 1). Mulally's pre-emptive financial and strategic choices are credited for Ford's successful turnaround.

In 2002, Ford cut approximately 20,000 jobs and closed numerous plants. Four years later, Ford launched a major restructuring plan it called "The Way Forward," which cut an additional 30,000 jobs (Shein, 2012, pp. 4–5).

Cutting the cost of labor, especially entitlement benefits, was a critical piece to Ford's turnaround. Ford successfully renegotiated salaried benefits with the UAW in 2007 and 2009, which garnered approximately \$500M in annual savings (Sherk, 2008). In addition, Ford struck a deal with the UAW that froze salaries at \$28 per hour for higher-tier employees and \$16 per hour for lower-tier new hires. The labor cost cutting measures implemented by Ford resulted in \$2 billion in annual savings (George, 2012).

Meanwhile, IBM broke a long standing tradition by hiring its first outsider as CEO in company history, Louis Gerstner (Applegate et al., 2009, p. 5). For IBM, cuts began with small items such as employee perks and jumped to eliminating over 40,000 eliminated jobs by early 1993 (Applegate et al., 2009).

#### ***b. Performance***

(1) Financial retrenchment choices: minimize. Ford and IBM implemented small efficiency improvements and cut unprofitable programs and

departments. Both of these tactics were quick to implement and produced small, but immediate savings while management implemented longer-term solutions.

(2) Financial retrenchment choices: manage. Efforts were made to cut vehicle development costs by “engineering a car once to serve multiple markets worldwide” (Shein, 2012, p. 2).

Ford simplified its product line from 20 to eight vehicles. The company improved manufacturing productivity by reducing the number of configurations for each of its remaining eight models. The redesigned Ford Explorer alone went from 76,000 configurations to 1,500. Ford also reduced its global suppliers from 3,300 in 2004 to 1,600 in 2009 by incorporating internationally compatible parts into its vehicle manufacturing designs.

From 2007 to 2011, Ford Motors divested Aston Martin, Volvo, Jaguar, Land Rover, and Mercury permitting focused investment to remaining brands Ford and Lincoln.

Ford and IBM revamped their organizational structure by eliminating layers of hierarchy and positions deemed to be redundant. Similar to Ford's *One Ford* turnaround slogan adopted several years later, *One IBM* was coined to mark the company's reorganization process. The IBM of 1993 had a complex organizational structure with numerous divisions with corresponding executives at the helm. IBM was inundated with deep levels of hierarchy, a heavy reliance on an army of corporate staff, and a consensus-driven decision-making culture. The divisions were consolidated under larger business groups with a streamlined leadership structure which were mandated to meet regularly to discuss and address issues as well as corporate strategy. Other cross functional teams were established to improve communication, management and responsiveness.

Ford made a strategic decision to break its heavy reliance on the gas-guzzling sport utility vehicles and trucks that had been hit hard by the rising fuel costs as well as government-mandated fuel economy regulations. A strategic shift was

made towards smaller cars that would be considered “best in its class in terms of quality, fuel efficiency, safety, smart design, and value” (Shein, 2012, p. 5).

IBM conducted the most drastic strategic repositioning by shifting heavy investment away from mainframe computers into cornering the market as the middleman or connector in the developing world of e-commerce based on the then fledgling internet. This new market position would establish IBM as a company that would serve as a bridge in the Internet age. IBM’s middleware provided the tools and technology that served as the interconnections between disparate and distributed data sources, applications, and computers (Applegate et al., 2009). Additionally, IBM recognized the growing demand for consulting as well as technology services to assist clients in their transition into the internet age, including acquisition/integration of technology, e-marketing, and e-commerce. Resources were shifted to IBM’s information technology service units, IBM Global Services, which grew to provide 38 percent of IBM’s revenue by 2000 (Applegate et al., 2009).

*c. Budget*

(1) Financial retrenchment choices: minimize. Ford implemented targeted budget cuts on its less profitable divisions. Ford also reduced dividend payouts four times and eventually suspended them (Shein, 2012). Ford also renegotiated contracts with its remaining suppliers to further reduce the cost of its material.

IBM used performance metrics to assist in budget allocations, and greater individual accountability was instituted, especially for managers and division vice-presidents. In addition, IBM launched a benchmarking study which compared the costs of individual IBM business units in relation to the competition.

(2) Financial retrenchment choices: manage. In addition to the numerous plants closed by Ford, 14 plants worldwide were placed in an idle status over a six year period (Shein, 2012). Ford also cut the number of suppliers by more than half and continually leveraged their buying power to garner optimal rates. Ford went to great



lengths to protect the economies of scale the U.S. automotive industry enjoyed, even testifying before Congress in support of its domestic competitors.

Based on studies and analysis, IBM fixed, closed, or sold business units that were either non-essential and/or underperforming. IBM also restructured internal transfer costs by opening them up to the free market competition, which forced units to either streamline or face outsourcing. In addition, IBM leveraged its considerable buying power with select suppliers.

## **B. ANALYTICAL FRAMEWORK — DEVELOPMENT**

### **1. Establishing the Three-Sector Framework**

The three-sector analytical framework is designed to ultimately compare DoD's financial retrenchment strategies and tactics to those of comparable government, quasi-government, and publicly traded organizations. In this chapter we compare financial choices of the comparable organizations across three sectors. DoD's choices are examined, incorporated, and compared in Chapter V.

In Table 3, the comparable organizations are grouped by sector atop the framework. Their financial choices, based on associated strategy and tactic, are represented by an "X" within the matrix. Financial retrenchment tactics, obtained from the literature, are first grouped by the strategy: minimize or manage. Then the financial choices are grouped by people, performance, and budget according to which group is either targeted or most influenced by the tactic. This three-sector framework is not intended to be an all-inclusive representation of every financial tactic available to an organization faced with retrenchment.

		ORGANIZATIONS						
			CALIFORNIA	MASSACHUSETTS	NEW JERSEY	USPS	AMTRAK	FORD
MINIMIZE	PEOPLE	Hiring Freeze			X	X		X
		Furlough	X	X	X			
		Restructure Workforce/Week	X			X		X
	PERFORMANCE	Small Efficiency Improvements <sup>1</sup>		X	X	X	X	X
		Cut Programs / Departments	X	X	X		X	X
		Burden Share	X	X	X		X	X
		Centralize Decision Making		X	X		X	
	BUDGET	Defer Spending / Maintenance	X	X		X	X	
		Performance Metrics		X			X	X
		Renegotiate Contracts		X	X		X	
		Targeted Budget Cuts	X	X	X		X	X
MANAGE	PEOPLE	Change Leadership						X
		Force Reductions	X	X	X	X	X	X
		Restructure Pay & Benefits	X	X	X	X	X	
		Early Retirement			X	X		X
	PERFORMANCE	Organizational Restructuring		X	X	X	X	X
		Large Efficiency Improvements <sup>2</sup>					X	X
		Low Cost Labor Alts <sup>3</sup>				X	X	X
		Strategic Repositioning					X	X
	BUDGET	Sell/Lease Capital Assets	X	X	X	X	X	X
		Budget Restructuring	X	X	X			X
		Leverage Buying Power			X			X
		Across-the-board Cuts						
		Spending Freeze	X		X			

- 1 Small efficiency improvements take less than 1 year to implement and realize savings  
2 Large efficiency improvements take more than 1 year to implement and realize savings  
3 Low cost labor alternatives include insourcing, outsourcing, and/or privatization.

Table 3. Three-Sector Analytical Framework – Comparative Organizations

## **C. COMPARATIVE ORGANIZATIONS — ANALYSIS**

### **1. Minimization Strategy and Tactics**

#### ***a. People***

All three sectors exhibited commonalities in hiring freezes and restructuring the workforce. The organizations that used these tactics did so immediately upon knowing they would internalize the effects of fiscal stress. This indicates that hiring freezes and restructuring the workforce or workweek are easy and quick to implement, produce immediate savings and have low impact on the existing workforce, organization's objectives, and long-term wellbeing. In all cases these tactics were insufficient at producing enough savings to avert more severe longer-term financial choices. At best, during times of acute fiscal stress these retrenchment tactics produced short-term budget flexibility.

Government organizations comprised the only sector to implement furloughs with all three states doing so. This would indicate a strong preference to maintain the workforce and avoid political implications of layoffs; however, all three state governments implemented force reductions. This suggests two findings. First, furloughs alone cannot generate the retrenchment savings demanded by acute fiscal stress. Second, furloughs were used to compliment force reductions because politicians prefer to recognize force reductions through attrition not layoffs. Therefore, especially in the case of New Jersey, furloughs, hiring freezes, early retirements, pay and benefit restructuring plans proved effective retrenchment tactics that supported force reduction by producing attrition, thereby reducing layoffs and minimizing political backlash. Therefore, in times of acute fiscal stress, government organizations implement furloughs to realize immediate savings, understanding it will produce attrition which ultimately supports force reduction goals.

#### ***b. Performance***

Implementing small efficiency improvements and cutting non-essential or unprofitable programs and departments had strong three-sector commonalities. These tactics can be quickly implemented to achieve immediate savings. Similar to hiring

freezes and workforce restructuring, these tactics were low-impact on the organizations and ultimately insufficient in producing enough savings to prevent more severe cuts.

Burden sharing and centralization of decision-making were a two-sector commonality between government and quasi-government organizations. Their implementation in only two sectors suggests a limiting factor that prevents every organization from using them.

The factor limiting the use of burden sharing was organizational autonomy. All three state organizations and Amtrak had the autonomy to directly implement burden sharing. By doing this, they were able to produce immediate savings with low impact upon their organization's objectives and long-term wellbeing. Publicly traded organizations, however, were unable to burden share the direct effects of their organizational retrenchment. The indirect effects of fiscal stress were passed to suppliers by way of decreased demand.

The limiting factor affecting publicly traded organizations' ability to centralize their decision-making was that their processes were already centralized. Both publicly traded organizations did, however, cut non-profitable divisions, and restructured their organizations along new business lines. However, they saw no need to centralize decision-making within new or existing divisions. This indicates that decision-making, unlike many government and quasi-government organizations, is already designed to be more centralized.

### *c. Budget*

All three sectors had one organization that used performance metrics. This indicates that all three sectors, when confronted with acute fiscal stress, become risk adverse at investing in inventive programs, products or services because of the high opportunity cost.

Deferring spending and maintenance was a two-sector retrenchment tactic exhibited by government and quasi-government organizations. These organizations preferred to defer costs to recognize current year savings. Government and quasi-

government organizations did not exhibit long-term concerns with this tactic. They instead assumed the maintenance and spending was legitimately not required in the current year, or would reasonably be provided for in out years.

Conversely, publicly traded organizations did not exhibit this financial choice because deferring maintenance and spending could adversely affect productivity of plants, property, and equipment. Publicly traded organizations preferred to evaluate the overall productivity of their divisions and make invest or divest decisions based on profitability.

Targeted budget cuts were evident in every government and publicly traded organization. The widespread occurrence of this tactic within these two sectors indicates that retrenchment necessitates it to balance a budget or remain profitable. That quasi-government organizations did not exhibit the tactics indicates that quasi-government organizations are over-reliant on government subsidies to cover costs in time of acute fiscal stress, or that our research did not uncover targeted cuts.

Renegotiating contracts was a two-sector retrenchment commonality between government and publicly traded organizations. This tactic was implemented by only two states and one company. Our research found this tactic provided immediate savings realized throughout the life of the contract. The tactic was easily implemented and had low impact on the organization and its long-term well-being. However, to implement this tactic necessitated an organization have contracts it was able to reduce quantity, quality, or performance of services without adverse effects upon the organization's mission. This suggests that the organization's contracting was needlessly incurring additional costs or services in times of relaxed or chronic scarcity.

## **2. Management Strategy and Tactics**

### ***a. People***

Force reductions were exhibited by every comparative organization. The prevalence of this tactic indicates that workforces will be reduced in times of financial retrenchment caused by multi-year acute fiscal stress. This reduction was the result of

organizations downsizing unprofitable or non-essential divisions, programs, services, or products.

Every government and quasi-government organization restructured its pay and benefits. This suggests that government and quasi-government organizations have unsustainable pay and benefit packages that are susceptible to restructuring in time of retrenchment. Ford also exhibited this tactic when it restructured UAW pay and benefits to remain profitable and avoid bankruptcy. IBM's pay and benefit packages were properly aligned with industry and the company's objectives.

Early retirements were offered in all three sectors. This tactic was intended to compliment force reductions, which were exhibited by every organization. Early retirements facilitated attrition, thereby reducing the amount of layoffs required to meet new staffing levels.

Publicly traded organizations were the only sector to exhibit leadership changes that resulted directly from multi-year acute fiscal stress. At Ford and IBM, new CEOs were specifically brought in from outside to manage the financial retrenchment process and recover the company. Both CEOs had a history of aggressive workforce reduction and cost-cutting measures. This indicates that organizations focused on aggressively managing revenues, expenditures, and investments to create profitability are apt to change leadership when faced with retrenchment.

#### ***b. Performance***

Organizational restructuring was a strong three-sector commonality. This indicates that organizations, when faced with retrenchment, reevaluate their structure and reorganize either as a result of divesting unprofitable or non-essential divisions, programs, or services—or to realize savings through organizational efficiencies.

Both publicly traded organizations exhibited every long-term performance tactic. This indicates that companies or organizations seeking to stem retrenchment and create long-term profitability are apt to aggressively implement significant and enduring changes to achieve those ends.

Conversely, states used the fewest long-term performance. States may have implemented long-term performance tactics in years not covered by this project, as we discovered by the magnitude of the fiscal stress. Nevertheless, this finding indicates that government organizations are slowest to implement tactics that have long-term effect upon performance. When Massachusetts and New Jersey attempted to organizationally restructure, they met with significant legislative conflict. Government organizations in general tried to avoid these tactics, and when they couldn't they were very guarded at their implementation.

*c. Budget*

Every organization sold or leased capital assets. The frequency of this tactic indicates it is a preferred retrenchment decision. Selling or leasing surplus property provided every organization significant income or savings with little impact on its mission. In our project, we found that arriving at the decision to sell or lease assets, receiving approval for the plan, and recognizing income or savings from the tactic was a long-term process with multi-year results.

Budget restructuring had a strong two-sector commonality between government and publicly traded organizations. Government motivations were twofold: Their intent was to bring transparency to government spending or to restrict future mismanagement of government finances. Publicly traded companies restructured along new business lines and shed non-profitable ones.

One government organization and both publicly traded organizations leveraged their buying power during the time frame examined by this project. It should be noted that California and Massachusetts were already members of the Western States Contracting Alliance in 2010 and 2009, respectively. Thus, leveraged buying power is perceived less as a retrenchment tactic and more as a normal business practice. Organizations faced with retrenchment evaluated new opportunities to leverage their buying power or maintain the buying power they already enjoyed.

Spending freezes were implemented by two state governments. Government organizations exhibited freezes on baselines and, in two instances, freezes

related to delayed approval of budget authority. Quasi-government and publicly traded organizations did not implement arbitrary spending freezes, choosing instead to invest in profitable operations and divest unprofitable operations.

Across-the-board cuts were not implemented by any organization. This indicates organizational belief that such a cut is a sub-optimal retrenchment choice. Organizations instead preferred targeted budget cuts because across-the-board cuts were thought to unduly hamper operations. They also prevented budget flexibility by preventing organizations from realigning slack resources to sufficiently meet and maintain operational objectives.

#### **D. CONCLUSION**

Chapter IV presented an examination of the financial retrenchment choices made by comparative organizations and associated those choices with a strategy and tactic. Next, a three-sector analytical framework was developed to categorize the comparative organizations' retrenchment choices.

Chapter V will examine the type and cause of DoD's fiscal stress. DoD's financial retrenchment choices are associated with a retrenchment strategy and tactic, and then added to the three-sector analytical framework for comparative analysis. The similarities, differences, and unique characteristics among choices are then evaluated.



## **V. DOD’S FINANCIAL RETRENCHMENT CHOICES — A COMPARATIVE ANALYSIS**

“The Defense enterprise is the largest and most complex organization in the world. With roughly three million employees, almost 5,000 locations, and a budget of more than \$600 billion, the Department is bigger than any Fortune 500 company today” (DoD SMP, 2013, p. 6). However, DoD is not immune to the effects of economic recession. The nation-wide recession, which began in 2008, placed downward pressure on federal spending. This resulted in the BCA of 2011, which established discretionary spending caps mandating \$500 billion in DoD outlay reductions between FY 2013–2022. These spending caps were temporarily delayed by the American Taxpayer Relief Act of 2012, but on March 1, 2013, Congress enacted the caps and sequestered \$37 billion from DoD’s current year budget. Now challenged by financial retrenchment, DoD must make difficult choices to balance operational requirements and multi-year commitments within new baselines made more uncertain by prospects of further congressional sequester.

The president’s FY 2014 budget request of \$527 billion supports and deepens the commitment to a new fiscal strategy (OUSD[C], 2013a). If the DoD continues to encounter financial retrenchment at the magnitude currently prescribed in law, readiness will deteriorate (DoD, 2013b).

Multiple reviews and analyses show that additional major cuts—especially those on the scale and timeline of sequestration—would require dramatic reductions in core military capabilities. Reductions on this scale would require the Department to manage risk, readiness, and mission requirements in a fundamentally different way than the U.S. military has been accustomed to. (DoD, 2013b, p. 10)

Figure 3 reflects the president’s FY 2014 budget request in comparison to prior FY funding and the projected estimates through FY 2018.

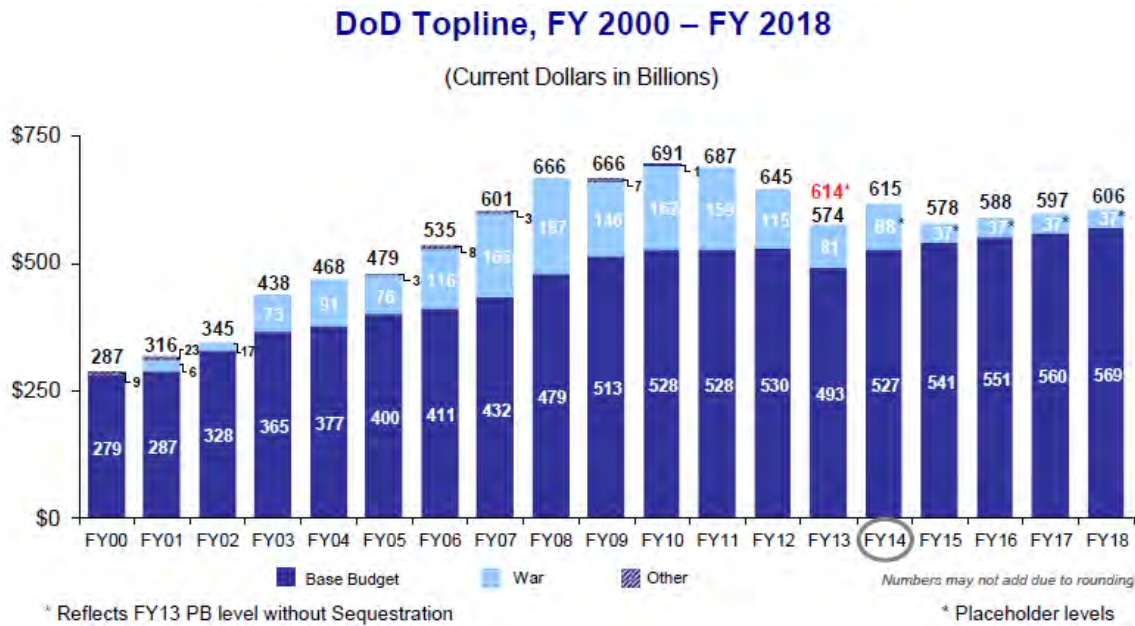


Figure 3. President’s FY 2014 Budget Request (from OUSD[C], 2013a)

To prepare DoD for the challenges ahead, Secretary Hagel tasked the Strategic Choices and Management Review Board to research and present financial retrenchment options to balance the strategic ends, ways, and means necessary to maintain the NSS and QDR objectives. The board “scrutinized every aspect of the DoD’s budget, including: contingency planning, business practices, force structure, pay and benefits, acquisition practices, and modernization portfolios” (Hagel, 2013a). Furthermore, the FY 2014 budget reflects a change in “defense-wide investments in all of these areas given the realities of a post-9/11 world. It also addresses difficult strategic choices regarding how to achieve a force ready for a wider variety of missions in an era of declining resources” (OUSD[C], 2013, p. 4-2).

## A. DEPARTMENT OF DEFENSE—DATA EXAMINATION

### 1. Type and Cause of Fiscal Stress

DoD exhibits acute fiscal stress resulting from external factors of problem depletion and environmental entropy. Problem depletion arose as the war in Iraq ended in 2012 and as the war in Afghanistan winds down in 2014. This is coupled with

environmental entropy caused by the 2008 economic recession. Since then, the U.S. government has faced downward pressure on federal spending as tax revenues decreased faster than expenditures and deficits became unsustainable. Congress' resulting actions were to change the nation's fiscal norm to retrenchment, and its tool was the BCA of 2011.

“The BCA of 2011 amended the Balanced Budget and Emergency Deficit Control Act of 1985 by reinstating discretionary spending limits for 2012–2021” (OMB, 2013c, p. 1). The limits for 2013 and 2014 were further reduced by the ATRA of 2012, when a Joint Select Committee on Deficit Reduction failed to propose, and then Congress failed to enact, comprehensive and responsible deficit reduction legislation. These spending limits are enforced by a sequestration of non-exempt discretionary budget authority that is ordered at the end of the current session of Congress if enacted appropriations exceed the limits (OMB, 2013c).

## **2. Rate and Duration of Fiscal Stress**

DoD is facing multi-year fiscal stress that is producing immediate financial retrenchment. The rate and duration of this multi-year fiscal stress, outlined by the BCA of 2011, is expected to last until at least 2021. This assumes that unforeseen externalities and congressional action don't alter the rate of discretionary spending outlined in the BCA of 2011.

The impact of this financial stress was felt immediately. Since the March 1, 2013, implementation of discretionary spending caps and sequester, DoD has experienced declining budgets that caused significant reductions in military modernization, force structure, personnel costs, and overhead expenditures (DoD, 2013a).

The impact is expected to last years as the DoD faces the continued prospect of sequestration in FY 2014 and continued discretionary spending caps out to 2021. The department's 2014 base budget request is \$526.6 billion; a \$0.9 billion decrease from the 2013 enacted base budget and a \$3.9 billion decrease from the 2012 enacted base budget (OMB, 2013b; OUSD[C], 2013b). “When measured in real terms against the growing cost of personnel, health care, and weapons, this represents a marked decrease in defense

purchasing power compared to the past decade” (DoD, 2013a, p. 1). DoD also stands to lose another \$52 billion from the 2014 defense budget through sequestration if Congress does not appropriate within the discretionary caps, or raise them (DoD, 2013a; OMBc, 2013).

The timing of these cuts is especially difficult to internalize since DoD has enjoyed extraordinary growth over the last ten years in funding. The department’s budget more than doubled between 2001 and 2012 (see Figure 3). Organizational leaders accustomed to 10 years of relaxed scarcity must now prepare DoD for a new fiscal reality of limited resources as the president and Congress signal a change in fiscal norm to retrenchment.

### **3. Retrenchment Choices that Support a Minimization Strategy**

An examination of DoD’s financial retrenchment choices revealed the following choices designed to support a strategy that to minimize the effects of multi-year acute fiscal stress. The choices are discussed and associated to a minimization tactic.

#### ***a. People***

To help achieve the \$37 billion spending reduction mandated by sequestration, DoD undertook hiring freezes (OUSD[C], 2013a) and furloughs of the civil service workforce. On May 14, 2013, Secretary Hagel announced the decision “to impose furloughs of up to 11 days on civilian employees to help close the budget gap caused by sequestration” (Hagel, 2013b).

#### ***b. Performance***

DoD’s performance minimization tactics included small efficiency improvements and program cuts. The FY 2014 budget continues efficiency initiatives

to reduce the cost of doing business by identifying opportunities for better use of resources. The Department continues to identify further reductions associated with more effective use of funds, terminating or restructuring weapons programs, restructuring or delaying military construction programs, and consolidating infrastructure. (OUSD[C], 2013b, p. 6-1)

These initiatives are estimated to save \$31 billion to be applied to deficit reduction.

*c. Budget*

DoD's budget minimization tactics included deferred spending and/or maintenance, performance metrics, renegotiated contracts, and targeted budget cuts. Sequestration has adversely impacted training, maintenance, and investment programs (OUSD[C], 2013a). Should sequestration continue "to achieve such rapid savings, the Department would first have to target accounts that yield the most immediate savings—modernization programs, training, and maintenance accounts" (DoD, 2013a, p. 1).

DoD immediately used performance metrics to guide its contracting efforts. In a new era of fiscal austerity, the president's FY 2014 budget reassessed acquisition programs and realigned funding based on the NSS and QDR priorities. Programs experiencing significant developmental problems, unsustainable cost growth, or are no longer on the Department's high priority list will be cancelled. "Terminations include, Missile Defense Agency Precision Tracking Space System development program (FY 2014, \$-270 million) and the Air Force's Expeditionary Combat Support System developmental effort (FY 2014, \$-76 million)" (OUSD[C], 2013b, p. 3-1). Other terminated or restructured programs include, but are not all inclusive: the High Mobility Multi-Wheeled Vehicle, Joint Air-to-Ground Missile, Ground Combat Vehicle, Joint Light Tactical Vehicle, and Family of Medium Tactical Vehicles (OUSD[C], 2012).

Targeted budget cuts in the president's FY 2014 budget include the Missile Defense Agency, Precision Tracking Space System, Expeditionary Combat Support System, C-27J Joint Cargo Aircraft, and numerous other programs (OUSD[C], 2013b). Training cycles have also been targeted. "As the demand signal in Afghanistan lessens, the Army is adapting their force generation process to better support the broader range of capabilities the new defense strategy requires. The new model reduces the active component from a 36-month training cycle to a 24-month cycle" (OUSD[C], 2013b, p. 4-3).

#### **4. Retrenchment Choices that Support a Management Strategy**

An examination of DoD's financial retrenchment choices revealed the following choices are designed to support a strategy to manage the effects of multi-year acute fiscal stress. The choices are discussed and associated with a management tactic.

##### ***a. People***

DoD changed leaders, reduced the size of its force, restructured its pay and benefits, and offered early retirements to civilian employees. President Obama selected Hagel to be secretary of defense, recognizing that his "willingness to defy party loyalty and conventional wisdom" (Shane & Sanger, 2013, p. 1) was essential to achieving DoD reform after more than a decade of war in Iraq and Afghanistan. Hagel's willingness to manage DoD's forthcoming retrenchment is arguably the most significant reason for his appointment, highlighted by the unwillingness of his predecessor, Secretary Panetta, to do the same.

The DoD implemented a force reduction plan spanning FY 2013 through FY 2017. The Department's overall military end strength included a 1.4 percent reduction in FY 2013, equating to a 31,300 reduction in end strength and a 5.5 percent reduction; equating to a 123,900; reduction in end strength by FY 2017 (OUSD[C], 2012).

DoD's Strategic Choices and Management Review Board concluded "that no serious attempt to achieve significant savings can avoid compensation costs, which consume roughly half of the DoD budget" (Hagel, 2013a). Approved reductions (or diminished growth) of pay and benefits include lower basic pay raises, basic allowance for housing, basic allowance for subsistence, and special pays and bonuses. Additionally, retiree healthcare changes that will be phased in over several years include increased TRICARE Prime enrollment fee, an enrollment fee for TRICARE Standard/Extra, an increase to Standard/Extra deductibles, and an increase in co-pays for pharmaceuticals, to name a few (OUSD[C], 2012).

DoD also implemented the Voluntary Early Retirement Authority, a cost-savings workforce restructuring initiative that helps DoD promote natural attrition by incentivizing eligible employees to voluntarily retire or resign. This opportunity is

available to both military and civil service employees in order to align DoD's workforce within current budget constraints.

***b. Performance***

DoD is organizationally restructuring, implementing large efficiency improvements and strategic repositioning the force. Specifically, organizational restructuring included a 20 percent reduction of senior civilian and military positions at major staff headquarters; consolidation and elimination of positions within the Office of the Secretary of Defense; and elimination of redundant positions, missions, commands, technology, intelligence, and facilities throughout the DoD. These efforts were estimated to save an estimated \$200 billion between FY 2012 and FY 2017 (Hagel, 2013a; DoD, 2013a).

To maximize return on investments, DoD sought efficiency improvement initiatives within its acquisition programs. DoD restructured the Standard Missile-3 Block IIB program to focus on common kill vehicle technology for the GBI exo-atmospheric kill vehicle, and future SM-3 variants. "Consolidating these into one technology effort accelerates our ability to address emerging threats and increase the protection of the homeland" (OUSD[C], 2013b, p. 3-4).

Other efficiency improvements focus on personnel-related initiatives. For example, the Defense Acquisition Workforce Development Fund improves the qualifications and experience of its acquisition workforce. Four specific initiatives include establish higher standards for key leadership positions, establish stronger professional qualification requirements, increase the recognition of excellence in acquisition management, and further increases a cost-consciousness workforce (OUSD[C], 2013b).

Finally, the president's FY 2013 budget called for the strategic repositioning of "a smaller and leaner force structure" to be implemented over five years from FY 2013 to FY 2017 (OUSD[C], 2012, p. 4-1). Service specific eliminations included: a minimum of eight Army Brigade Combat Teams; seven Navy cruisers and two Dock Landing Ships; one Marine Corps infantry regiment headquarters, five infantry

battalions (four active and one reserve), one artillery battalion, four Tactical Air squadrons (three active and one reserve), and one combat logistics battalion; and six Air Force combat coded fighter squadrons (one active and five reserve components) and one (active) non-combat coded fighter squadron (OUSD[C], 2012, pp. 4-1–4-2).

*c. Budget*

DoD has sold and/or leased capital assets, leveraged its buying power, and force implemented across-the-board cuts. During periods of retrenchment, leasing options become a more attractive method to acquire “an asset without having to secure appropriations for the entire cost of the asset up front. An operating lease spreads the cost of the asset over several years, albeit often at a higher cost to the Government” (Lee, 2003, p. 7).

DoD’s Better Buying Power (BBP) 2.0 initiative leverages buying power and promotes greater efficiencies central “to increase productivity in defense spending to deliver better value to the taxpayer and Warfighter” (OUSD[C], 2013b, p. 6-7). The BBP consists of 36 initiatives, organized into seven overarching categories:

achieve affordable programs; control costs throughout the product lifecycle; incentivize productivity and innovation in industry and government; eliminate unproductive processes and bureaucracy; promote effective competition; improve tradecraft in acquisition of services; and improve the professionalism of the total acquisition workforce. (OUSD[C], 2013b, p. 6-7)

Finally, DoD force implemented \$37 billion in legislatively mandated across-the-board cuts, as consequence of the BCA of 2011 sequester.

**B. THREE-SECTOR ANALYTICAL FRAMEWORK**

Table 4 incorporates DoD’s financial retrenchment choices within the framework we developed in Chapter IV. DoD’s commonalities and differences among government, quasi-government, and publicly traded organizations are then analyzed in the next section.



ORGANIZATIONS			MINIMIZE							
			CALIFORNIA	MASSACHUSETTS	NEW JERSEY	USPS	AMTRAK	FORD	IBM	DOD
MINIMIZE	PEOPLE	Hiring Freeze			X	X		X		X
		Furlough	X	X	X					X
		Restructure Workforce/Week	X			X		X	X	
	PERFORMANCE	Small Efficiency Improvements <sup>1</sup>		X	X	X	X	X	X	X
		Cut Programs / Departments	X	X	X		X	X	X	X
		Burden Share	X	X	X		X	X		
		Centralize Decision Making		X	X		X			
	BUDGET	Defer Spending / Maintenance	X	X		X	X			X
		Performance Metrics		X			X		X	X
		Renegotiate Contracts		X	X			X		X
Targeted Budget Cuts		X	X	X			X	X	X	
MANAGE	PEOPLE	Change Leadership						X	X	X
		Force Reductions	X	X	X	X	X	X	X	X
		Restructure Pay & Benefits	X	X	X	X	X	X		X
		Early Retirement			X	X		X	X	X
	PERFORMANCE	Organizational Restructuring		X	X	X	X	X	X	X
		Large Efficiency Improvements <sup>2</sup>					X	X	X	X
		Low Cost Labor Alts <sup>3</sup>				X	X	X	X	
		Strategic Repositioning					X	X	X	X
	BUDGET	Sell/Lease Capital Assets	X	X	X	X	X	X	X	X
		Budget Restructuring	X	X	X			X	X	
		Leverage Buying Power			X			X	X	X
		Across-the-board Cuts								X
		Spending Freeze	X		X					

- 1 Small efficiency improvements take less than 1 year to implement and realize savings  
2 Large efficiency improvements take more than 1 year to implement and realize savings  
3 Low cost labor alternatives include insourcing, outsourcing, and/or privatization.

Table 4. Three-Sector Analytical Framework – DoD

## **C. DEPARTMENT OF DEFENSE—COMPARATIVE ANALYSIS**

### **1. Minimization Strategy and Tactics**

DoD's financial retrenchment choices, having been examined and associated with a minimization tactic, are incorporated into the three-sector framework. An analysis of similarities and differences to government, quasi-government, and publicly traded organizations is presented in this section.

#### ***a. People***

DoD's implementation of hiring freezes and furloughs indicates their financial retrenchment choices reflect those of government organizations in times of multi-year acute fiscal stress. The analysis of comparative organizations found that government organizations implemented hiring freezes and furloughs to realize immediate savings with low impact on the organization's objectives and long-term well-being. Because these tactics alone produced insufficient savings, government organizations used these tactics in conjunction with force reductions, understanding they would produce attrition, thus ultimately supporting force reduction goals while reducing political backlash.

#### ***b. Performance***

DoD's retrenchment choice to pursue small efficiency improvements and cut non-essential programs and commands reflected those of all three comparative sectors. The analysis of comparative organizations found that in times of multi-year acute fiscal stress, all sectors used these tactics because they could be quickly implemented, achieved immediate savings, and were low-impact on the organizations.

DoD's inability to burden share the direct effects of financial retrenchment reflected similarities with the publicly traded sector. DoD and IBM did not pass cuts to a subordinate organization. Like publicly traded organizations, suppliers of many of DoD's acquisition programs suffered the indirect effects of lower demand for major force acquisitions.

DoD, like publicly traded organizations, also did not centralize its decision-making processes. DoD did, however, divest non-essential commands and units. The decision-making within remaining commands was left unchanged, which also reflects the publicly traded sector. This indicates that DoD's decision-making process is already centralized.

*c. Budget*

DoD's retrenchment choice to use performance metrics in its acquisition decisions reflected those of all three comparative sectors. The analysis of comparative organizations found that in times of multi-year acute fiscal stress, all sectors became risk adverse at investing in inventive programs, products, or services because of the high opportunity cost. This also reflects DoD's decision to cancel innovative procurement programs, opting instead for legacy equipment that satisfies the NSS and QDR requirements with lower risk of cost overruns.

DoD's retrenchment choice to defer spending and maintenance is unique from the comparative organizations. Its implementation was the direct byproduct of force implemented across-the-board cuts and legislative mandates that inhibited how DoD could administer them. DoD did not want to defer maintenance and spending because it was viewed as having a direct and immediate effect upon readiness. This reflects the publicly traded sector that chose not to defer spending and maintenance in order to avoid adverse effects upon productivity. Conversely, government and quasi-government organizations did not exhibit long-term concerns with this tactics and thus freely deferred spending and maintenance.

DoD's financial retrenchment choice to implement targeted budget cuts reflects those of government and publicly traded organizations. Like the comparative organizations, targeted budget cuts were necessary to balance requirements with available funding. Targeted budget cuts allowed DoD leadership to target programs with the lowest impact on overall readiness.

DoD's financial retrenchment decision to implement the BBP 2.0 initiative and renegotiate delivery of other major force program contracts reflects the comparative

government and publicly traded sectors. The analysis of comparative organizations found that government and publicly traded organizations were apt to renegotiate contracts, but those organizations needed to have contracts with excessive or unnecessary quantity, quality, or performance requirements. Similarly, DoD renegotiated delivery of major force program contracts that had the lowest impact on its operational ability to satisfy the NSS and QDR requirements or were excessive to begin with.

DoD exhibited every financial retrenchment choice designed to produce immediate savings to the budget. The only comparative organization to do this was Massachusetts. That DoD and Massachusetts exhibited every one of these financial retrenchment choices indicates how extensively the organizations were retrenched. It also suggests these financial choices are preferred, because they yield immediate savings with lower impact than other options to personnel and performance.

## **2. Management Strategy and Tactics**

DoD's financial retrenchment choices, having been examined and associated with a management tactic, are incorporated into the three-sector framework. An analysis of similarities and differences to government, quasi-government and publicly traded organizations is presented in this section.

### ***a. People***

DoD's financial retrenchment choice to implement force reductions reflected all three sectors of comparative organizations in times of multi-year acute fiscal stress. The analysis of comparative organizations found that force reductions were a natural consequence of multi-year acute fiscal stress, and the losses often reflected downsizing non-essential divisions, programs, services, or products. This reflects DoD's retrenchment decisions, which have and will continue to cut non-essential commands, units and programs from the force.

DoD's retrenchment decision to restructure pay and benefits reflects that of the government sector. The analysis of comparative organizations found that the restructuring of pay and benefits was prevalent in the government sector because these

government organizations had unsustainable pay and benefit packages that were susceptible to restructuring in times of retrenchment. Ford also exhibited this tactic, but the other publicly traded company analyzed had a pay and benefit program that was aligned with industry and corporate objectives. DoD concedes its pay and benefit structure is unsustainable and continues to lobby congress for further modifications.

DoD's financial retrenchment choice to implement early retirement packages for military and civilian employees reflects that of all three comparative sectors. The analysis of comparative organizations found that the tactic was intended to compliment force reductions because they facilitated attrition and thus, reduced the amount of involuntary separations required to meet new staffing levels. DoD's Voluntary Early Retirement Authority explicitly states that it is a cost savings workforce restructuring initiative that promotes natural attrition.

Finally, DoD's leadership change reflects the publicly traded sector. The analysis of comparative organizations found that organizations, which were focused on aggressively managing revenues, expenditures, and investments to create profitability, are apt to change leadership when faced with retrenchment. The leadership change to Secretary Hagel did just this. It provided the president and DoD with a manager who was accepting of retrenchment and focused on aggressively managing expenditures and investments within legislatively mandated budget limitations. On July 22, 2013, Secretary Hagel announced that the Pentagon "must fundamentally reshape itself to adapt for a future of strategic and budgetary challenges" (DoD, 2013c, p. 1). He went on to note that DoD must prepare for the future and set clear, strategic priorities within the framework of a new fiscal reality and fewer resources (DoD, 2013c).

#### ***b. Performance***

DoD's retrenchment choice to organizationally restructure reflected those of all three comparative sectors. The analysis of comparative organizations found that in times of multi-year acute fiscal stress, organizations reevaluated their structure and reorganized as a result of divesting non-essential divisions or to realize organizational efficiencies. DoD's organizational restructuring is two-fold. It exhibited budget based

organizational restructuring as reflected by the comparative organizations. It also exhibited operational restructuring, such as the pacific tilt toward northern Asia.

DoD's retrenchment choices to initiate large efficiency improvements and strategically reposition the force ultimately supports the earlier finding that a leadership change influenced the organization's retrenchment decisions. The analysis of comparative organizations found that in times of multi-year acute fiscal stress, publicly traded organizations seeking to stem retrenchment and create long-term profitability were apt to aggressively implement significant and enduring changes to achieve those ends. Conversely, government organizations were slowest to implement these tactics and tried to avoid them, and, when unable to avoid them, were guarded at their implementation.

DoD is a government organization, lacking autonomy, whose retrenchment response largely depends upon its leadership's standpoint. Therefore, DoD's willingness to aggressively pursue large efficiency improvements and strategically reposition supports the finding that Secretary Hagel, like the public sector CEO's, is focused on aggressively managing revenues, expenditures, and investments to create operational readiness within legislatively mandated budget limitations. It is reasonable to assume that DoD, under different leadership, may have been slower to implement these tactics, tried to avoid them altogether, and when forced into action, been guarded in their implementation.

### *c. Budget*

DoD's financial retrenchment choice to sell capital assets reflected those of every comparative organization. The analysis of comparative organizations found that selling or leasing surplus was a preferred choice and provided significant income or savings with little impact on organizational performance.

DoD's decision to leverage its buying power reflected every comparative organization but can be considered a normal business practice often revisited during time of financial retrenchments. The analysis of comparative organizations found that one government and both publicly traded organizations exhibited this tactic, but all organizations faced with retrenchment evaluated new opportunities to leverage or

maintain their buying power. DoD, like the comparative organizations exhibited this tactic in times of relaxed scarcity and revisited it during acute scarcity, thus indicating DoD was reevaluating the potential to recognize additional low-impact long-term savings.

DoD was the only organization that managed across-the-board cuts. The retrenchment choice to apply across-the-board cuts was legislatively forced upon DoD. Across-the-board cuts, known as sequestration, was a political tool that produced immediate short-term savings at the detriment of programs and operations unable to absorb such cuts. The fact that no other organization selected across-the-board cuts as a financial retrenchment choice indicates across-the-board cuts are a sub-optimal retrenchment choice.

Most organizations, DoD included, believe equitable cuts unduly hamper operations. Senior leaders are prevented the budget flexibility they desire because it prevents them from realigning slack resources across the organization to sufficiently meet and maintain operational objectives.

This finding also provides a sense of severity about the fiscal stress facing our federal government. The fiscal stress upon our nation must demand a response if Congress were to design and agree to this retrenchment tool. That Congress ultimately enacted a sub-optimal retrenchment tool may highlight the inability of our lawmakers to reach consensus on federal priorities that are subsequent to controlling the deficit.

#### **D. CONCLUSION**

DoD is in the midst of an acute multi-year fiscal stress and is devising financial retrenchment strategies and tactics to close the fiscal deficit. The prolonged nature of the fiscal stress coupled with the profound cuts outlined in the BCA of 2011 force DoD to make tough financial retrenchment decisions to achieve fiscal solvency. DoD's current strategies and tactics were compared to other government, quasi-government, and publicly traded industries to determine where commonalities and difference exist.

The analysis found that DoD's financial retrenchment choices are characteristic of comparative organizations, with the exception of across-the board cuts. DoD's financial retrenchment choices toward its workforce reflects traditional choices of government organizations faced with multi-year acute fiscal stress. In addition, DoD's financial retrenchment choices affecting organizational performance reflect those of the publicly traded sector. However, their implementation depends largely upon organizational leadership and the influence of DoD's lack of autonomy and inability to burden share. Finally, DoD's financial retrenchment choices affecting the budget are similar to those of comparative organizations with one critical exception—across-the-board cuts. DoD's implementation of across-the-board cuts was legislatively mandated and undesired. Resultantly, across-the-board cuts influenced more severe cost cutting tactics.

Chapter VI provides a summary of our findings, recommendations for future research, and conclusions based on information collected and analyzed in Chapters I–V.



## **VI. CONCLUSIONS AND RECOMMENDATIONS**

### **A. RESEARCH QUESTION**

This project compared DoD's financial retrenchment choices to those of comparable government, quasi-government, and publicly traded organizations. Based on these comparisons, we identified sectoral similarities and differences to determine whether DoD's financial retrenchment choices are characteristic of an organization under similar fiscal stress, or unique to the DoD.

### **B. FINDINGS**

DoD's work force retrenchment choices reflected those of the government sector. Financial retrenchment caused by multi-year acute fiscal stress necessitated work force reductions by every organization. Government organizations used hiring freezes, furloughs, and early retirement packages to create immediate savings and produce attrition, thus supporting force reduction goals and reducing political backlash.

DoD's retrenchment choices affecting organizational performance depend largely upon organizational leadership and, to a lesser extent, DoD's lack of autonomy and inability to burden share. Leaders of organizations that were limited in autonomy were quicker to implement minimization and management strategies. Conversely, government organizations with full autonomy were slower to implement long-term performance initiatives as part of their management strategy. Fully autonomous government organizations tried to avoid long-term performance initiatives and, when forced into action, were guarded in their implementation.

The DoD has been quicker to accept the new fiscal norm and implement minimization and management strategies, which most closely reflect the behavior of publicly traded organizations. Secretary Hagel, within five months of taking office, stated financial retrenchment is the new fiscal norm and that long-term retrenchment choices must be devised and implemented (DoD, 2013c).

The two publicly traded organizations examined in this project aggressively managed expenditures and investment within budget limitations to achieve organizational objectives. These characteristics were also evident within DoD, as Secretary Hagel announced the DoD “must fundamentally reshape itself to adapt for a future of strategic and budgetary challenges” (DoD, 2013c, p. 1). Then on March 18, 2013, just one month after taking office and two weeks after the 2013 sequester, Secretary Hagel formed the Strategic Choices and Management Review board, tasking it to examine the choices underlying the department’s strategy, force posture, investments, and institutional management. “This Strategic Choices and Management Review will define the major decisions that must be made in the decade ahead to preserve and adapt our defense strategy, our force and our institutions under a range of future budgetary scenarios” (Garamone, 2013, p. 1).

This finding highlighted the significance of implementing leadership change during times of financial retrenchment and suggests that DoD’s retrenchment choices were previously insufficient to achieve the necessary savings mandated under the new fiscal norm. It also suggests previous leadership were not as aggressive as they should have been, which as discussed in the literature review, is a common behavior that people resist change and attempt to avoid or delay internalizing the effects of retrenchment.

DoD’s retrenchment choices affecting the budget exhibit one critical exception; it was the only organization to manage across-the-board cuts. An across-the-board cut, known as sequestration, was a political tool that produced immediate short-term savings at the detriment of programs and operations unable to absorb such cuts. No other organization examined selected this retrenchment tactic, thus indicating it is a sub-optimal financial retrenchment choice. It is noted that DoD’s implementation of across-the-board cuts was legislatively mandated and undesired.

This finding also provided a sense of severity about the multi-year acute fiscal stress confronting the federal government. Congress’ decision to create and ultimately enact a sub-optimal financial retrenchment tool highlights their consensus that the deficit is unsustainable and their discord regarding how to manage it.

Across-the-board cuts prevented DoD from realigning slack resources across the organization to sufficiently meet and maintain operational objectives. Thus, more severe cost cutting tactics were implemented. Specifically, DoD chose to defer maintenance and spending on current year operations. DoD's organizational preferences regarding the deferral of spending and maintenance otherwise reflected those of publicly traded organizations, which did not defer maintenance and spending because it was harmful to productivity.

This project also found that DoD, like the comparative organizations, became risk adverse in their procurement and investment decisions, preferring proven programs, products, or services because of the high opportunity cost of delays and failure. Financial retrenchment due to multi-year acute fiscal stress also necessitated, in every government and publicly traded organization, targeted budget cuts to balance revenues and expenditures. DoD and every comparative organization also sold or leased back surplus properly to realize low-impact income or savings. Thus these tactics are characteristic of multiple sectors and are attributed to the type and cause of fiscal stress.

Findings also included insight into how organizations select retrenchment strategies. Multi-year acute fiscal stress caused by external factors necessitated a cohesive multi-strategy approach to achieve fiscal solvency and lasting results. Every government and quasi-government organization was simultaneously implementing resist, delay, minimize, and management strategies and tactics. Furthermore, findings show that multi-year acute fiscal stress ultimately exhausted low-impact cuts and efficiency savings, which required organizations to make substantial cuts to workforces, programs, and services.

The extent to which strategies and tactics were favored depended on organizational autonomy and its ability to burden share. Organizations with full autonomy preferred resist and delay tactics. All three state governments raised revenue, provided rosy or optimistic economic scenarios, burden shared, and exhibited budgetary gamesmanship. Organizations limited in autonomy exhibited far less resist and delay strategies and tactics. These organizations, like DoD, would try, with limited success to obtain additional funding, modify restrictive directives, or delay consequences of

retrenchment. The result is that organizations limited in autonomy and restricted in their ability to burden share adopt minimization and management strategies more rapidly.

Publicly traded companies exhibited the fewest resist and delay strategies. Companies needed to quickly adapt to economic situations to achieve profitability. Leadership changes, exhibited by both Ford and IBM, were the critical tactics that shifted publicly traded companies from resist and delay strategies to aggressive minimization and management retrenchment strategies. A change in leadership was especially evident when the cause of acute fiscal stress was external and required an immediate response to achieve a successful turnaround.

Finally, this project revealed that government and quasi-government organizations have unsustainable pay and benefit packages that are susceptible to restructuring in times of retrenchment. Multi-year acute fiscal stress necessitated every government organization significantly change their pay and benefit packages. DoD has already reduced the rate of growth of military pay raises to one percent, which is beneath the government's average rate of inflation. DoD also stopped multiple special and combat pays, reduced basic allowances for housing, and proposed an increase to working-age retirees' medical premiums. Findings indicate that financial retrenchment caused by multi-year acute fiscal stress will necessitate that DoD must further deepen cuts to military pay and benefits to achieve solvency.

Based on our findings, we determined the DoD's financial retrenchment choices, during times of multi-year acute fiscal stress, are characteristic of comparative organizations with the exception of across-the-board cuts. Furthermore, multi-year acute fiscal stress exhausted low-impact cuts and efficiency savings, which ultimately demanded substantial cuts with long-term operational consequences. Therefore, implementing leadership change and long-term strategic plans were significant characteristics of effective retrenchment management within organizations lacking autonomy. New leaders were quicker to implement aggressive retrenchment strategies and strategic plans thereby minimizing sub-optimal cuts and promoting long-term organizational recovery.

## **C. RECOMMENDATIONS FOR FUTURE STUDY**

The topic of financial retrenchment within the DoD is timely and relevant. This project endeavored to examine the financial retrenchment choices of the DoD. Based on our three-sector framework, we identified sectoral similarities and differences to determine whether DoD's financial retrenchment choices were characteristic of an organization under similar fiscal stress, or unique to the DoD.

Further research opportunities in the area of defense financial retrenchment include:

- An analytical comparison of organizational retrenchment strategies and tactics to consequences to determine whether a correlation exists among choices and effects.
- An analysis of where organizations invest during times of multi-year acute fiscal stress.
- A comparison of the financial retrenchment choices of other federal government departments or agencies to the DoD.
- A comparison of post-war financial retrenchment choices of foreign nations to the DoD.
- A historical comparison of the post-war financial retrenchment choices of the DoD.
- Implications of across-the-board cuts upon the DoD's financial retrenchment choices, specifically related to operational readiness and/or maintenance.
- Identify and define a comprehensive list of financial retrenchment tactics. Discuss their application and associate them with a retrenchment strategy.
- Examine what strategies and tactics are most appropriate to combat various types of fiscal stress.

- An evaluation of the extent and impact autonomy influences retrenchment decisions in a fiscally constrained environment.

## **D. CONCLUSIONS**

Our research found that multi-year acute fiscal stress caused by external factors necessitated a cohesive multi-strategy approach to achieve fiscal solvency and lasting results. Organizations with less autonomy had to implement minimize and manage strategies and tactics sooner and to greater extent. The DoD's financial retrenchment choices were further hampered by legislative mandates that required across-the-board cuts and shielded various line items, such as military pay and benefits.

Our finding that DoD's financial retrenchment choices are characteristic of comparative organizations, except for across-the-board cuts, does not account for the utility of the retrenchment choices themselves. However, it was evident that every organization faced with financial retrenchment exhibited a preference for tactics that had the lowest impact upon the organization. Further, organizations such as DoD that are limited in autonomy and unable to burden share, must substantially retrench when confronted with multi-year acute fiscal stress caused by external factors. As such, organizations eventually run out of low-impact cuts or efficiencies to bridge the financial gap. The result is that real cuts to the organization and its operations must occur at a much deeper and quicker rate than those of an organization with autonomy and the ability to burden share.

Successful organizations develop a plan early and use it to guide its retrenchment choices that create budget flexibility to enable investment along new lines of operations. The result is an organization that weathers the multi-year acute fiscal stress and emerges well positioned to meet its operational requirements well into the future. Without a plan the organization runs the risk of allowing its fiscal condition to dictate how and where cuts must be made potentially resulting in sub-optimal decisions and unduly restricting the organizations ability to operate.

We recommend the DoD create a fiscal strategic plan for its enterprise to promulgate and guide its financial retrenchment choices. This plan should adequately

provide a force structure and alignment able to combat prospective national security threats within a new fiscal reality defined by fewer resources. The plan's financial requirements should be negotiated with Congress and used to guide the DoD's financial retrenchment decisions and minimize sub-optimal cuts that unnecessarily hamper the military's long-term restructuring. Some steps have already been taken toward these ends, but more must be done. Secretary Hagel has signaled the DoD must prepare to deepen cuts and has appointed the Strategic Management Review Board to develop alternative solutions.

THIS PAGE INTENTIONALLY LEFT BLANK



## LIST OF REFERENCES

39 U.S.C. § 201

9/11 Commission—National Commission on Terrorist Attacks Upon the United States (9/11 Commission). (2004, July 20). *The 9/11 Commission report: Final report of the National Commission on Terrorist Attacks upon the United States—Executive summary*. Retrieved from [http://govinfo.library.unt.edu/911/report/911Report\\_Exec.htm](http://govinfo.library.unt.edu/911/report/911Report_Exec.htm)

Applegate, L., Austin, R., & Collins, E. (2009). *IBM's decade of transformation: Turnaround to growth* (9-805-130). Retrieved from <http://vivie.edublogs.org/files/2013/05/HBR-IBM-Decade-of-Transformation-2b152b5.pdf>

American Taxpayer Relief Act of 2012, Pub. L. No. 112–240, § 26, 126 Stat. 2313 (2013).

Arnett, S. B. (2012). *Fiscal stress in the US states: An analysis of measures and responses*. Retrieved from [http://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1035&context=pmap\\_dis](http://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1035&context=pmap_dis)

Brook, D. (2013, Fall). *Responding to fiscal constraints* [Coursework, Class GB4053, session 10-1]. Monterey, CA: Naval Postgraduate School, Graduate School of Business and Public Policy.

Budget Control Act of 2011, Pub. L. No. 112–25, § 31, 125 Stat. 240 (2011).

Commonwealth of Massachusetts. (2008, January 23). Governor's 2009 budget recommendation H.2. Retrieved from <http://www.mass.gov/bb/h1/fy2009h1/>

Commonwealth of Massachusetts. (2009, June 30). *Commonwealth of Massachusetts comprehensive annual financial report for the fiscal year ended June 30, 2009*. Retrieved from <http://www.mass.gov/osc/docs/reports-audits/cafr/2009/title-page-and-toc-linked.pdf>

Congressional Budget Office (CBO). (2003). *The past and future of U.S. passenger rail service: A CBO study*. Retrieved from <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/45xx/doc4571/09-26-passengerrail.pdf>

Dauster, W. G. (2008). The congressional budget process. In E. Garrett, E. A. Graddy, & J. E. Howell (Eds.), *Fiscal challenges: An interdisciplinary approach to budget policy* (pp. 4–35). New York, NY: Cambridge University Press.

- Department of Defense (DoD). (2013a, April). *Defense budget priorities and choices fiscal year 2014*. Retrieved from <http://www.defense.gov/pubs/DefenseBudgetPrioritiesChoicesFiscalYear2014.pdf>
- Department of Defense (DoD). (2013b, July 1). *Strategic management plan: The business of defense FY2014–FY2015*. Retrieved from [http://www.defense.gov/pubs/pdfs/FY14-15\\_SMP.pdf](http://www.defense.gov/pubs/pdfs/FY14-15_SMP.pdf)
- Department of Defense (DoD). (2013c, July 22). *Veterans of foreign wars national convention as delivered by Secretary of Defense Chuck Hagel, Louisville, KY, Monday, July 22, 2013* [Speech]. Retrieved from <http://www.defense.gov/speeches/>
- Garamone, J. (2013, March 18). Hagel tasks civilian, military leaders to examine strategy. *American Forces Press Service*. Retrieved from <http://www.defense.gov/news/newsarticle.aspx?id=119557>
- George, W. (2012) The big 3 roar back. *Harvard Business Review*, 9–412–0702.
- General Accounting Office (GAO). (1995). *Intercity passenger rail: Financial and operating conditions threaten Amtrak's long-term viability* (GAO-95-71). Washington, DC: U.S. Government Printing Office.
- Government Accountability Office (GAO). (2010). *U.S. Postal Service: Strategies and options to facilitate progress toward financial viability* (GAO-10-455). Washington, DC: U.S. Government Printing Office.
- Groves, S. M., Godsey, W. M., & Shulman, M. A. (1981). Financial indicators for local government. *Public Budgeting & Finance*, 1(2), 5–19.
- Hagel, C. T. (2013a, July 31). *Statement on strategic choices and management review*. Speech presented at the Pentagon Press Briefing Room, Arlington, VA. Retrieved from <http://www.defense.gov/releases/>
- Hagel, C. T. (2013b, August 6). *Secretary Of Defense Chuck Hagel's message on reducing civilian furloughs*. Speech presented at the Pentagon Press Briefing Room, Arlington, VA. Retrieved from <http://www.defense.gov/releases/>
- Hester, T. (2009, May 18). New Jersey state employee furloughs underway. *New Jersey Newsroom*. Retrieved from <http://ns2.newjerseynewsroom.com/state/state-workers-to-denounce-dmv-furloughs>
- Johnson, K., & Krisher, T. (2008, December 10). Ford bailout money unnecessary, company says. *Huffington Post*. Retrieved from <http://www.huffingtonpost.com>

- Kosar, K. R. (2012, January 27). *The U.S. Postal Service's financial condition: Overview and issues for Congress* (CRS Report No. R41024). Retrieved from <http://www.fas.org/sfp/crs/misc/R41024.pdf>
- Lee, S. S. K. (2003, October). *Capital and operating leases: A research report*. Retrieved from Federal Accounting Standards Advisory Board website: <http://www.fasab.gov/pdffiles/combinedleasev4.pdf>
- Levine, C. H. (1980a). More on cutback management: Hard questions for hard times. In C. H. Levine (Ed.), *Managing fiscal stress: The crisis in the public sector* (pp. 305–312). Chatham, NJ: Chatham House.
- Levine, C. H. (1980b). Organizational decline and cutback management. In C. H. Levine (Ed.), *Managing fiscal stress: The crisis in the public sector* (pp. 13–30). Chatham, NJ: Chatham House.
- McCaffery, J. L., & Jones, L. R. (Eds.). (2001). *Public budgeting and financial management in the federal government (HC)* (Vol. 1). Charlotte, NC: Information Age.
- Moe, R. C. (2001). The emerging federal quasi government: Issues of management and accountability. *Public Administration Review*, 61(3), 290–312.
- Moe, R. C., & Stanton, T. H. (1989). Government-sponsored enterprises as federal instrumentalities: Reconciling private management with public accountability. *Public Administration Review*, 49(4), 321–29.
- National Association of State Budget Officers (NABSO). (2010, June). *The fiscal survey of states* (June 2010). Retrieved from <http://www.nasbo.org/sites/default/files/Spring%202010%20Fiscal%20Survey.pdf>
- National Railroad Passenger Corporation. (2013). *Amtrak commits to ending food and beverage losses* [News release]. Retrieved from <http://www.amtrak.com/ccurl/196/210/Amtrak-Commits-End-Food-Beverage-Losses-ATK-13-115.pdf>
- Office of Management and Budget (OMB). (2013a). *Table 5.6—Budget authority for discretionary programs: 1976–2018*. Retrieved from <http://www.whitehouse.gov/omb/budget/historicals>
- Office of Management and Budget (OMB). (2013c, August 20). *OMB sequestration update report to the president and congress for fiscal year 2014*. Retrieved from [http://www.whitehouse.gov/sites/default/files/omb/assets/legislative\\_reports/sequestration/sequestration\\_update\\_august2013.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/sequestration/sequestration_update_august2013.pdf)

- Office of Management and Budget (OMB). (2013b, April 10). *Fiscal year 2014 budget of the U.S. government*. Retrieved from <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/budget.pdf>
- Office of the Under Secretary of Defense (Comptroller) (OUSD[C]). (2012, February). *Overview United States Department of Defense fiscal year 2013 budget request*. Retrieved from [http://dcmo.defense.gov/publications/documents/FY2013\\_Budget\\_Request\\_Overview\\_Book.pdf](http://dcmo.defense.gov/publications/documents/FY2013_Budget_Request_Overview_Book.pdf)
- Office of the Under Secretary of Defense (Comptroller) (OUSD[C]). (2013a, April). *Fiscal year 2014 budget request and FY 2013 update*. Retrieved from [http://comptroller.defense.gov/defbudget/fy2014/FY2014\\_Budget\\_Request.pdf](http://comptroller.defense.gov/defbudget/fy2014/FY2014_Budget_Request.pdf)
- Office of the Under Secretary of Defense (Comptroller) (OUSD[C]). (2013b, April). *Overview United States Department of Defense fiscal year 2014 budget request*. Retrieved from [http://comptroller.defense.gov/defbudget/fy2014/FY2014\\_Budget\\_Request\\_Overview\\_Book.pdf](http://comptroller.defense.gov/defbudget/fy2014/FY2014_Budget_Request_Overview_Book.pdf)
- Peters, B. G., & Rose, R. (1980). The growth of government and the political consequences of economic overload. In C. H. Levine (Ed.), *Managing fiscal stress: The crisis in the public sector* (pp. 33–51). Chatham, NJ: Chatham House Publishers.
- Postal Reorganization Act of 1970, Pub. L. No. 91-375, § 201, 84 Stat. 719 (1970).
- Rose, R. (1980). *Misperceiving public expenditure: Feelings about “cuts.”* Glasgow, UK: University of Strathclyde, Center for the Study of Public Policy.
- Rubin, I. (1980). Retrenchment and flexibility in public organizations. *Fiscal Stress and Public Policy*, 159–178.
- Scheinberg, P. F. (1998). *Intercity passenger rail: Outlook for improving Amtrak’s financial health: Statement of Phyllis F. Scheinberg, Associate Director, Transportation Issues, Resources, Community, and Economic Development Division, before the Subcommittee on Transportation, Committee on Appropriations, U.S. Senate*. Washington, DC: General Accounting Office.
- Schick, A. (1980). Budgetary adaptations to resource scarcity. *Fiscal Stress and Public Policy*, 113–134.
- Schick, A. (1986). Macro-budgetary adaptations to fiscal stress in industrialized democracies. *Public Administration Review*, 124–134.

- Schmitt, A., & Raisch, S. (2013). Corporate turnarounds: The duality of retrenchment and recovery. *Journal of Management Studies*, 50, 1216–1244.
- Shane, S. & Sanger, D. E. (2013, January 6). Obama's pick for defense is an ally, and lightning rod. *The New York Times*, pp. 1–2. Retrieved from <http://www.nytimes.com/2013/01/07/us/obama-expected-to-select-hagel-for-defense-post.html?pagewanted=1&r=0>
- Sherk, J. (2008). Auto bailout ignores excessive labor costs (Report No. 2135). Retrieved from <http://www.heritage.org/research/reports/2008/11/auto-bailout-ignores-excessive-labor-costs>
- Shein, J., & Bell, M. (2012). *At Ford, turnaround is job one* (HBS No. KEL663). Evanston, IL: Northwestern University, Kellogg School of Management.
- State of California. (2010a, January 8). Governor's budget summary 2010–2011. Retrieved from <http://www.dof.ca.gov/budget/historical/2010-11>
- State of California. (2010b, May 14). Governor's budget May revision 2010–2011. Retrieved from <http://www.dof.ca.gov/budget/historical/2010-11>
- State of California. (2010c, June 30). State of California comprehensive annual financial report fiscal year ended June 30, 2010. Retrieved from [http://www.sco.ca.gov/ard\\_state\\_cafr.html](http://www.sco.ca.gov/ard_state_cafr.html)
- State of California. (2010d, October 8). California state budget 2010–11. Retrieved from <http://www.ebudget.ca.gov/2010-11-EN/pdf/Enacted/BudgetSummary/FullBudgetSummary.pdf>
- State of New Jersey. (2008, February 26). Fiscal 2009 budget in brief. Retrieved from <http://www.state.nj.us/treasury/omb>
- State of New Jersey. (2009, June 30). State of New Jersey comprehensive annual financial report fiscal year ended June 30, 2009. Retrieved from <http://www.state.nj.us/treasury/omb/publications/10cafr/pdf/intro.pdf>
- Taylor III, A. (2007, January 26). Behind Ford's scary \$12.7 billion loss. *CNN Money*. Retrieved from [http://money.cnn.com/2007/01/26/news/companies/pluggedin\\_taylor\\_ford.fortune](http://money.cnn.com/2007/01/26/news/companies/pluggedin_taylor_ford.fortune)
- U.S. Census. (2010). Census results interactive map. Retrieved from <http://www.census.gov/2010census/data/>
- Wang, X., Dennis, L., & Tu, Y. S. J. (2007). Measuring financial condition: A study of US states. *Public Budgeting & Finance*, 27(2), 1–21.

Wildavsky, A. B., & Caiden, N. (2004). *The new politics of the budgetary process*. Glenview, IL: Scott, Foresman.

Wolman, H., & Davis, B. (1980). Local government strategies to cope with fiscal pressure. *Fiscal Stress and Public Policy*, 231–248.

## **INITIAL DISTRIBUTION LIST**

1. Defense Technical Information Center  
Ft. Belvoir, Virginia
2. Dudley Knox Library  
Naval Postgraduate School  
Monterey, California